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Tax Planning for the Investment Portfolio of a Commercial Bank

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MANY OF YOU no doubt have heard that "nothing is certain in life except death and taxes." And so if taxes are as certain as death itself, then why tax planning?

This question can be answered, I think, in two parts. First, inevitable as taxes clearly are, they are not certain. Widely different and, therefore, uncertain tax consequences can result from business transactions simply by the fact of form and arrangement. Secondly, and again notwithstanding the inevitability of taxes, it is still possible, as with death, to defer or delay the day of reckoning.

These then might really provide one form of a definition of tax planning, which we might say is the careful arrangement of business transactions in a manner that will produce the most favorable tax result both from an absolute tax dollar standpoint and from the standpoint of when such taxes must be paid.

Let me raise this question. Does this mean that taxes should be the pivotal point in the arrangement of a business transaction? Definitely not! Tax objectives should be designed to harmonize with normal business operations and objectives rather than to control them. A sound and learned approach to tax planning will be a balanced one—one that will permit taxes to take their rightful place as *a* major consideration but not *the* major one in any affected business decision. In attempting to place the proper emphasis on the role of taxes in business planning let us not, however, minimize their importance. The fact cannot be overlooked that in the final analysis the ultimate stockholders' test of successful business management is the amount of net profits available for re-investment or for distribution as a dividend. In this, the era of the forty-eight per cent corporate tax rate, taxes, by and large, will match these available profits dollar for dollar.

To the success of the commercial bank and particularly to the success of its investment portfolio operation, tax planning is no less important than it is to business as a whole.

OBJECTIVES AND LIMITATIONS

In any discussion of tax planning such as this, at least two basic approaches are possible. The discussion could take the form of a pre-

sentation of a series of blueprints or designs, each of which would permit tax savings when applied to the given set of business or economic circumstances for which designed. This approach, while full of merit in the view of those listeners faced with identical circumstances, is not entirely consistent with the aforementioned definition of tax planning. To those who applied such blueprints, tax planning in this sense would not constitute a careful arrangement of business transactions consistent with basic business objectives. Rather, this would amount to the mechanical arrangement of such transactions so as to fit the blueprint so designed.

The other approach, and the one I think is most appealing, comprehends an attempt to highlight areas of planning opportunity and at the same time provides enough of the general background surrounding the highlighted areas to permit an understanding of the reasons why these areas are particularly conducive to tax planning.

This approach, in its application, then requires that the individual responsible for tax planning be constantly aware not only of the tax rules but also of the other business considerations that will influence the area to which effective tax planning is to be directed.

Why *Bank* Portfolio Tax Planning

Except for the obvious fact that the composition of this audience justified limiting the discussion to *bank* portfolio tax planning, one might wonder why it is necessary or even desirable to single out banks. Why not, for example, investment-company portfolio tax planning or, better still, portfolio tax planning in general? Is not one portfolio the same as another portfolio? Might I ask, when you've seen one, haven't you seen them all?

I don't think so. The first clue to the reason for this distinction lies in the Internal Revenue Code itself. Section 581 of the 1954 Code provides a definition of a commercial bank for tax purposes and in so doing provides real insight concerning the unique nature of the portfolio of a commercial bank. A bank, for tax purposes, is defined in part as a "bank or trust company doing business under the laws of the United States . . ., a substantial part of the business of which consists of receiving deposits and of making loans and discounts." By implication this definition, of course, provides that a substantial part of the business of a bank is not the business of portfolio investment. This then is the first distinguishing factor. The portfolio operations of a bank, unlike the

portfolio operations of an investment company, are an incidental rather than a primary activity.

The second reason for the distinction is the fact that banks in some respects are given special recognition under the tax laws and as a result are the beneficiaries of certain tax rules which by design or otherwise permit special planning opportunity.

THE COMMERCIAL BANK'S INVESTMENT PORTFOLIO

For better or for worse, but nevertheless consistent with the Internal Revenue Code, throughout this discussion we shall proceed on the premise that the major business of a bank is to lend money for credit-worthy purposes or, in other words, to make good loans. Funds not so lent but still employed for income purposes will be viewed as residually employed funds. These are the funds encompassing the investment portfolio. Simply speaking, they are the excess of invested capital and customer deposits over the working capital needs of the bank and its customer loan demand.

Residual Nature of Portfolio Funds

Let us consider briefly this residual concept since it will permeate all the following substantive comments regarding areas of planning opportunity.

While the lending function of the bank must be primary at all times, it should be obvious to most that as a matter of operational necessity not all the bank's funds can be invested in loans. Some funds of the commercial bank must be allocated to reserves. Primary reserves, generally in the form of cash items yielding no direct return, must be maintained to meet the day-to-day operating costs of the bank. Secondary reserves in a non-cash but nevertheless very liquid form and, as a result, yielding a comparatively low return, must be maintained to meet the seasonal needs of the bank. It is only after these demands have been satisfied and after current loan demand has been met that funds will be allocated to the investment reserve or to the active portfolio. It is in this context that the investment portfolio is regarded as residual.

CONSIDERATIONS IN PORTFOLIO MANAGEMENT

Once funds do become available in this manner, it becomes necessary for the bank to make a choice of the medium in which these funds will be invested. Banks are not, of course, allowed to rely exclusively

on their own discretion in making this choice. Various standards established by the myriad regulatory agencies concerned will influence both the quantity and the quality of the investments. But even more important are the business factors that will influence the makeup of the investment portfolio. Some brief consideration of them at this point appears warranted.

First, however, a word of caution! This is by no means intended as a capsule course in portfolio management. Such a course is not capable of being capsuled into the time allotted. The brief mention that will be given to these various considerations is merely an attempt to provide a general awareness of them in order to give practical business meaning to the tax planning areas to be discussed. It is hoped also that an awareness of these factors will direct attention to their depth and, by so doing, will illustrate, in a fashion, one of the basic tax-planning principles that, hopefully, will be conveyed by this presentation, namely, the need for continued liaison and coöperation between the individual or department responsible for portfolio tax matters and those responsible for portfolio operations in general. Without this liaison, the best designed and most carefully executed tax plan might well produce no benefit and could conceivably result in a detriment when later sacrificed at the altar of true business objectives.

Generally, the major factors that will influence the composition of an investment portfolio are three: (1) liquidity requirements, (2) capital adequacy considerations and (3) the income factor.

Liquidity Requirements

The catchall phrase *liquidity requirements* is indeed a broad categorization. In this broad sense it encompasses all the various factors and considerations that will establish the degree of liquidity, deemed by management to be adequate or necessary in order to meet the bank's specific obligations and business purposes. The investment portfolio, residual as it is, will obviously be greatly influenced by variations and shadings in each and every one of these considerations. Taking just two basic ones, we can see how great the impact on the portfolio will be. First, consider the influence of the need to maintain adequate semiliquid assets to meet fluctuations in deposit withdrawal demand, a factor over which the bank's management can exert very little influence. Consider next the need to maintain a sufficient degree of liquidity necessary to permit the ready conversion of funds from portfolio investments to

more lucrative loan investments. The influence of considerations such as these on the makeup of the bank's portfolio cannot be overemphasized. The significance of this as an essential element in successful portfolio tax planning will also become more obvious as specific areas of planning opportunity are further developed. For the moment, however, it should suffice to say that it is a factor that cannot be ignored by the tax planner especially in view of the fact that gains and losses, key elements in virtually all portfolio tax planning, result largely from conversions of funds to meet liquidity needs.

The Capital Adequacy Factor

An understanding of the capital adequacy factor as a consideration in portfolio management consists, for these purposes, merely of an awareness of the fact that continued shareholder and depositor confidence in a bank requires:

1) that available funds be allocated in accordance with established ratios to both risk and non-risk assets, and
2) that gains and losses from portfolio operations will be reflected in the earnings and subsequently in the capital accounts of the bank.

Obviously, a bank is going to derive a greater current return from a poorly rated municipal security than from a triple-A-rated one, and yet could the bank's management afford to overlook the effect that such investments collectively might have on depositor confidence? This then is the essence of the capital adequacy factor: How can the portfolio manager best employ his available funds so as to provide the greatest possible return without at the same time adversely affecting all the various ratios that historically must be maintained in order to sustain investor and depositor confidence?

The Income Factor

The third and final factor, the income factor, really needs no definition. Simply stated it is also a question: What investment will provide the bank with the greatest after-tax yield in terms both of current income and of anticipated gain or loss upon conversion?

In many ways the income factor is the tax factor. To be sure, an evaluation of the expected yield from a prospective portfolio investment requires more than a mere perusal of the stated rate of return. It also requires, for example, a projection of the effect that an ultimate gain or

loss upon conversion of the security to cash or another security will have upon the stated yield. But this projection cannot be effected, and even the stated yield itself cannot be properly evaluated, without consideration of the tax factor.

The Role of Taxes

It would obviously be a misstatement of fact to say that this tax factor in portfolio management is overlooked. With a forty-eight per cent tax rate this is hardly possible. There is nevertheless a considerable amount of sentiment for the view that, even though the tax factor *itself* is not overlooked, the opportunities presented by it are. Possibly the reason for this lies in the fact that much tax planning requires the voluntary realization of losses lodged in investment portfolios with the consequent reflection in earnings. Many bankers, however, have realized that tax maneuvering, far from accentuating portfolio losses, can actually be used to soften their effect. But not all have been so fortunate! In 1962 the American Bankers Association reported that "one of the most widely misunderstood aspects of the management of the commercial bank investment portfolio is the net losses on sales of securities that result from the inherent nature of the operations of commercial banks. A surprising number of individuals—including directors in many smaller banks—feel that depreciation of securities is a sign of poor portfolio management, and that realized losses should be avoided at all costs."

With the background that has just been provided, the ensuing comments are an attempt to dispel some of this misconception.

TAX PRINCIPLES AND CONCEPTS

Before proceeding to the specific areas of planning opportunity that blend with these general principles of portfolio management, a brief review of some of the more important tax concepts and rules affecting portfolio operations seems appropriate.

Concept of Capital Gains and Losses

Paramount among these is, of course, the tax concept of capital asset and the "privileged" rate position given to the taxation of gains realized from the sale or exchange thereof. By definition, a capital asset is any asset other than (1) stock in trade or property held for sale to customers, (2) property subject to depreciation allowances or real property used in a trade or business, (3) certain copyrights and

artistic compositions, (4) accounts or notes receivable acquired in the ordinary course of business for services rendered or from the sale of stock in trade, and (5) certain short-term governmental obligations issued at a discount. Normally then (assuming that short-term governmental obligations are not considered part of the investment portfolio) the definition of capital asset would include all portfolio securities.

Gains from the sale or exchange of a capital asset are, of course, taxed at a maximum rate of 25 per cent if they are long term or if they result from the sale or exchange of an asset held for more than six months. Losses on comparable assets are normally offsettable against income or deductible only to the extent of capital gains.

A very significant exception to the capital gains rules is made for banks. Section 582(c) of the Internal Revenue Code permits a bank to offset against its other operating income the excess in any given year of its bond losses over its bond gains. The section provides in effect that these *net* bond losses will be treated as ordinary losses rather than as losses from the sale or exchange of capital assets.

Note that the concept of capital asset envisions a sale or exchange. The tax incidence of portfolio gains and losses, like the accounting treatment approved by most regulatory agencies, is in their realization, not in their incurrence. Except for a bank that conducts a dealer activity, no tax effect can be given to write-ups and write-downs for market fluctuations. This is a key element in portfolio tax planning, since realization of gains and losses is largely a voluntary thing and is something that can therefore be regulated so as to provide the maximum tax benefit.

Premium Amortization

The second basic tax concept affecting portfolio operations is that of premium amortization. Since 1942 the tax law has given recognition and effect to the fact that part of the difference between the cost of a security and the proceeds realized upon its sale or redemption is, in effect, an adjustment of yield and therefore a period cost rather than a capital loss. Section 171 of the Internal Revenue Code provides a series of complex rules whereby over the holding period of a bond any premium paid can be amortized and offset against the interest income derived currently therefrom. For fully taxable securities this amortization procedure is elective. If elected, it gives rise to a deduction from ordinary taxable income and a concurrent adjustment to the tax basis or

cost of the security to which it relates. For tax-exempt and partially tax-exempt securities it is mandatory. No deduction is allowed for amortization of premium on tax-exempt securities.

Other Concepts

Other concepts of importance that will enter into the ensuing comments will be explained therein to the extent necessary. These include, but are not necessarily limited to, the concept of bond discount, tax-exempt and partially tax-exempt income, and the wash-sale rules. Time does not permit even a brief review of all these principles.

AREAS OF PLANNING OPPORTUNITY

Foremost among the tax savings devices available to banks is the judicious use and timing of security sales. The net bond-loss deduction provided in section 582 (c), IRC, provides the opportunity, if not the mechanics, for obtaining the maximum tax benefit from security losses and at the same time for reducing to a minimum the tax that must be paid on security gains.

The Nature of Bank Portfolio Losses

In enacting this provision with the Revenue Act of 1942, the Congress recognized the unique function of bonds and the unusual nature of bond losses in the commercial bank investment portfolio. The Senate Finance Committee Report on the Revenue Act of 1942 stated that this special treatment was provided for banks "since bonds are a necessary type of investment for them." What the Congress seemed to be saying was that, for banks, bond losses are ordinary or routine rather than capital in the normal investment-loss sense. Banks' losses on interest-bearing portfolio securities are the inevitable result of our monetary system and of the role of banks therein rather than the result of a miscalculation of market potential.

Much of the losses incurred by banks in portfolio securities are viewed by bankers themselves as the result of Federal Reserve System efforts to limit the range of fluctuations in the level of economic activity. In periods of declining economic activity there will be a slack demand for loans, and banks, to keep their funds fully employed, will enter the market and buy securities. This increased activity in the bond market, coupled with a lower going interest rate, tends to drive up the price of securities, and banks, accordingly, end up purchasing relatively high-priced investments. As the economy moves into the recovery phase,

loan demand increases and ultimately, in order to satisfy the demands of their customers, banks are forced to liquidate investments. This frequently requires the disposition of the high-cost securities at a loss because the price of these securities will have fallen as a result of the rise in the interest rate accompanying the increase in loan demand.

Restated, this means simply that banks invest residual funds when loan demand is low and when loan demand is low security prices are high. The effect is that banks are frequently investing in high-priced securities. Conversely, banks liquidate investments when loan demand is high and when loan demand is high security prices are low. The net result is frequent and foreseeable security losses.

Opportunity for Advance Planning

The interplay of the net bond-loss deduction with these circumstances, giving rise to frequent anticipated security losses, provides banks with an unusual tax planning opportunity. In most non-bank cases, tax planning with respect to security losses is wholly after-the-fact. In these cases, it is limited to very little more than an attempt to time the realization of losses already incurred so as to recoup the most tax benefit from an adverse economic situation. Banks, on the other hand, because they can anticipate losses, are in a position to plan in advance.

The planning techniques responsive to this opportunity are essentially two:

First, a defensive technique: The bank should, as a matter of practice, avail itself of the net bond-loss deduction as a means of minimizing the economic impact of the routine losses that will be incurred in the investment portfolio.

Second, an aggressive technique: To the extent consistent with other bank objectives, the bank should avail itself of the net bond-loss deduction as a means of maximizing investment income.

A Means of Minimizing Impact of Losses—
Principle of Segregating Gains and Losses

The first technique, in its application, is a very simple one. Because of the fact that the preferential treatment provided for bond losses is limited to net bond losses or to the excess of losses over gains in any given taxable year, maximum benefit will be derived when bond losses and bond gains are realized in alternate years. In the optimum situation for a bank in the 48 per cent tax bracket the maximum tax benefit will accrue if bond gains can all be realized in one taxable year and be taxed

at capital gain rates (maximum 25 per cent if long term) and bond losses can all be taken in another year to offset ordinary income (deduction worth 48 per cent). Obviously this optimum situation is not easily or frequently going to be achieved. It is the role of the portfolio tax planner to see that the greatest possible benefit is derived. The need for liaison in accomplishing this should be obvious.

The determination of whether a given taxable year should be a gain year or a loss year is generally something over which the tax planner can exert very little influence. He can, of course, control and establish a pattern to the extent that the losses to be taken will be taken voluntarily in order to obtain a present tax benefit. But the incurrence of losses in the course of security liquidations to meet customer loan demand is beyond his control. The determination of the type of year a given year will be in these circumstances, will depend largely on economic forecasting. If the need for funds arises early in the year, the bank may be forced to forecast and to decide at an early date. It would, of course, be preferable to avoid both purchases and sales until a point of time in the year when it is possible properly to assess the economic situation that will prevail for the entire year. Such delay will not, however, always be possible.

Having taken a gain or loss, the bank will be largely committed to treating the remainder of the year in the same fashion. On the surface, this might seem to pose a large mechanical problem and yet in practice it might not. If early losses are taken, it is probable that the increased loan demand which necessitated liquidating securities at a loss will be accompanied by a drop in security prices during that year. The likelihood of continued losses is, therefore, good. If on the other hand security prices rise, making the realization of gains likely, the rise in prices is likely to be accompanied by a decrease in loan demand and the bank is consequently not likely to be under pressure for funds. The converse is true if early gains are taken.

A Means of Maximizing Investment Return—Tax Swapping

The second technique, using the net bond-loss deduction to maximize investment income, is a little more complex than the first and yet quite simple. In the preceding comments we assumed that portfolio losses were largely incurred in security liquidations necessary to provide funds for non-portfolio uses—generally to satisfy customer loan demand. This second technique, popularly known as "tax swapping," generally permits a greater effect from a tax standpoint while permit-

ting the continued employment of the funds realized in the investment portfolio.

In its simplest form, tax swapping comprehends the voluntary taking of a tax loss and the reinvestment of the proceeds derived from the sale in a similar security, thereby setting the stage for the recoupment, in the form of a later capital gain, of all or a part of the present economic loss. A simple illustration will describe this better than many words.

Assume that a bank has in its portfolio a security purchased at a cost of $1,000 and currently selling at $960. Assume further that the bank can and does acquire another security for $960, providing the same yield and containing substantially the same maturity and credit characteristics. Assume for these purposes a 50 per cent corporate tax rate.

If the bank sells the security for $960, it undeniably realizes a present economic loss of $40. If, however, this loss is incurred in a loss year, the bank will recoup $20 of the $40 economic loss in the form of a tax deduction against ordinary operating income. If the bank holds the purchased security to maturity, and assuming more than six months have elapsed since its purchase, the bank will pay a maximum capital gains tax of $10 on the appreciation of the security. The net result will be a $10 after-tax gain to the bank attributable solely to the earlier realization of the loss. To the extent that the bank might be forced to sell the security before maturity at a price lower than face value, the benefit to be derived from the tax swap will, of course, be reduced, but even if the price ultimately falls below the purchase price of $960, some benefit will be derived.

The benefit from the tax swap is twofold. First, it is in the potential absolute tax savings that can be effected by the differential between ordinary and capital gain rates. In this sense it permits maximizing the investment return. But further than this and frequently overlooked is the benefit derived in the form of a tax deferral to the extent of the immediate tax deduction derived from the realized loss and the consequent reduction in taxes. In the preceding example, the net tax savings from the sale, repurchase, and ultimate redemption was $10; however, during the period between the sale and the redemption the bank had the use of $20, which was not paid currently as taxes on other income solely because the loss was realized. At the same time, the bank's portfolio position remained unchanged. One $1,000 bond was substituted for a similar $1,000 bond.

LIMITATIONS ON THE USE OF TAX SWAPPING

Tax swapping can unquestionably improve a bank's investment income, and sound management would dictate that it should be practiced by every bank having a sufficient amount of security losses in its portfolio to make the swaps feasible. In the normal course of events, swapping does not, however, improve the investment income to a point where it equals the income that can be derived from good loans. This then presents a practical business limitation on the use of the technique. It is doubtful that it would be wise to generate a portfolio simply to take advantage of tax swapping.

Although statistics on the use of swapping are not available, there is fairly widespread indication that it is not used to the extent warranted. Possibly the reason for this lies in the misunderstanding of the nature of portfolio losses cited in the earlier quotation from the report of the American Bankers Association. Portfolio managers may be reluctant to take security losses in the mistaken belief that to do so would reflect unfavorably on their success as managers.

On the other hand, possibly the reluctance stems from a sense of business ethics holding that to take advantage of concessions and ambiguities in the tax law is not entirely proper. This obviously is not the place for a protracted discussion of the ethical concepts concerned, but the thoughts of the eminent jurist, Judge Learned Hand, in this regard may place the question, if there is one, in context. Judge Hand said of legitimate tax avoidance: "Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant."

Judge Hand's answer might well be different if the sole motivation for the maintenance of the portfolio and of the related portfolio activity is the potential tax benefit to be derived therefrom. But there is, of course, a much better reason for the normal commercial bank's investment portfolio and, to reiterate a prior comment, the business wisdom of maintaining a portfolio merely for tax swapping is, at best, suspect.

The Wash Sale Rule

From a tax standpoint alone, the only limitation on the use of this swapping technique is the wash-sale rule. Section 1091 of the Internal Revenue Code denies an investor the recognition of losses resulting from

the sale or disposition of investment securities if the investor acquires "substantially identical" securities within a period of thirty days before or after the disposition. This provision clearly limits tax maneuverability but, in the abundant security market of today, it can be overcome. The significant element of the wash-sale rule is the phrase "substantially identical." Factors given consideration in determining whether securities are substantially identical or not include maturity and call dates, interest rates, eligibility for payment of estate taxes, eligibility as investments for commercial banks. When a determination is necessary, reference should be made to the guidelines available in published rulings and articles.

A VARIATION OF TAX SWAPPING

To a large extent the foregoing comments regarding ways in which tax savings can be realized are all tailored to market situations in which security losses will be obtained. To the ordinary investor this would seem like planning for doom. To the bank, however, it is not so dark as it might appear, since the circumstances giving rise to many of the losses are high customer loan demand, a condition dear to most bankers' hearts.

Limited planning opportunity also exists in less fortunate economic circumstances for banks. As has been previously noted, when loan demand is slack and banks are in the position of having sizable excess reserves, they frequently enter the market and end up purchasing securities at premium prices. For taxable securities this premium can either be amortized and over the life of the bond offset against ordinary income or be taken as a loss when the security is sold or redeemed.

The elective amortization provisions provide a further opportunity to rotate investments for the tax benefit to be derived. By selling and repurchasing a bond that is currently selling at a premium, the bank, for the price of a current capital gains tax, can "purchase" ordinary deductions in the form of amortizable bond premium, which can in turn provide an ultimate tax benefit in excess of the capital gains tax prematurely paid. The following example will illustrate the possibilities of this technique.

Assume that a bank has in its portfolio a bond with a tax basis of $1,000 and currently selling at a premium of $40, or for $1,040. If the bank sells and simultaneously repurchases the same security, it will pay an immediate capital gains tax of $10 and will have "acquired" amortiz-

able bond premium in the amount of $40. The benefit that will be derived from this amortization is $20 ($40 x assumed tax rate of 50 per cent) if the bond is held to maturity, providing a net gain from the swap of $10. In this circumstance, the reverse of the tax deferral benefit results since the capital gains tax is probably prematurely paid and this factor would certainly have to be considered in evaluating the monetary benefit to be derived from a prospective swap.

OTHER AWARENESSES

Time does not permit a detailed discussion of other tax-saving opportunities inherent in bank portfolio operations. The remainder, however, are more in the nature of awarenesses than tax-saving techniques and it should, therefore, be appropriate to cover them in this fashion.

A most significant outlet for the investment of surplus bank funds is the tax-exempt securities of state and local governments, commonly known as municipal bonds. Since the deductibility of interest paid by banks on their customer deposits is not subject to challenge even if the funds upon which interest is paid are used to purchase tax-exempt securities, municipal bonds represent a very attractive investment for banks from a tax standpoint. The yield on municipal bonds generally reflects their tax-exempt status to a bank in the 48 per cent surtax bracket, and for this reason a bank in the 22 per cent normal tax bracket should carefully evaluate the effective yield before making such an investment.

Since the income from municipal bonds is tax-exempt, whereas the gains realized from the sale or exchange thereof are not, banks should avoid, to the extent possible, the purchase of tax-exempt securities selling at a discount, unless it is reasonable to assume that when the security is disposed of no gain will be realized.

Although the wash-sale rule was enacted to prevent abuse, it can in some instances be used to the advantage of the portfolio tax planner. If a mistake is made by prematurely realizing a loss, a repurchase of the same or a "substantially identical" security within thirty days would reverse the loss and place the bank in substantially the same position as it was before the loss was realized.

A bank that makes a market in securities will be classed as a dealer in securities for federal income tax purposes. Gains on the sale of

inventory securities by a dealer are taxed as ordinary income. A variety of inventory valuations and costing methods are available, not the least of which is the LIFO method of determining cost and market or the lower of cost or market as a means of periodic valuation.

CONCLUSION

It was not the purpose of this discussion to consider all of the various facets of taxes as elements in effective portfolio management. I make no claim of having accomplished this. It was, however, my purpose to generate an awareness of tax planning opportunities; an awareness which, if effectively pursued, would permit significant tax savings. In a word, the message of this discussion has been to emphasize the need for tax orientation, a need that the late J. K. Lasser viewed as follows:

> Reduced to its simplest terms, the problem of the business man is to discover which of the alternatives open to him under the income tax law will at once fully discharge his tax liabilities, and leave him in the most advantageous position to advance the conduct of his business.

I sincerely hope that the need for such tax orientation in bank portfolio operations has been effectively conveyed.