

Business Tax Reform and Rate Reduction Act of 1987
Article 32-Franchise Tax on Banking Corporations

Introduction

The Business Tax Reform and Rate Reduction Act of 1987 (Chapter 817, Laws of 1987) amended Article 32 of the Tax Law pertaining to the franchise tax on banking corporations. The thrust of the amendment is to return the windfall New York State would have received as a result of the federal disallowance of a specifically computed bad debt deduction for large banks and the reduction in the amount of the bad debt deduction allowed thrift institutions. Chapter 817 also makes technical and clarifying changes and amends provisions of Article 32 pertaining to additions and subtractions in the computation of entire net income of banking corporations, the calculation of the asset tax on banking corporations, and the computation of the receipts factor of a banking corporation.

Computation of Entire Net Income

Starting Point

Chapter 817 clarifies the starting point for the computation of entire net income by a banking corporation. Entire net income is defined as total net income from all sources which shall be the same as the entire taxable income (but not alternative minimum taxable income)

- (1) which the taxpayer is required to report to the United States Treasury Department, subject to the modifications and adjustments provided in Article 32, or
- (2) which the taxpayer, in the case of a corporation which is exempt from federal income tax (other than the tax on unrelated business taxable income imposed under section 511 of the IRC) but is subject to tax under Article 32, would have been required to report to the United States treasury department but for such exemptions, subject to the modifications and adjustments provided in Article 32, or
- (3) which, in the case of a corporation organized under the laws of a country other than the United States, is effectively connected with the conduct of a trade or business within the United States as determined under Section 882 of the IRC subject to the modifications and adjustments provided in Article 32.

Large Bank Bad Debt Provisions

For purposes of section 1453(b)(11) & (12), (e)(13) & (14) and subsection (i), a bank is a large bank (one subject to IRC Section 585(c)) if for the taxable year (or for any preceding taxable year beginning after December 31, 1986) the average adjusted bases of all assets of such bank exceeded \$500 million, or if the bank was a member of a parent-subsidiary controlled group (for

federal income tax purposes) and the average adjusted bases of all assets of the group exceeded \$500 million.

Two new paragraphs have been added to Section 1453(b) pertaining to additions to federal taxable income in computing entire net income. New paragraph (11) requires a large bank to add to its federal taxable income its bad debts allowed as a deduction pursuant to IRC Section 166. New paragraph (12) requires a large bank to add to its federal taxable income 20 percent of the excess of its Section 1453(i) bad debt deduction over the deduction which would have been allowable had the large bank maintained its bad debt reserve for all taxable years on the basis of actual experience.

Two new paragraphs have been added to Section 1453(e) pertaining to subtractions from federal taxable income in computing entire net income.

New paragraph (13) allows a large bank which recaptures its balance of the reserve for losses on loans to subtract from federal taxable income any amount included in federal taxable income pursuant to IRC Section 585(c). New paragraph (14) allows a large bank to subtract from federal taxable income any amount included in federal taxable income as a result of a recovery of a loan.

New subsection (i) of Section 1453 allows a large bank to subtract from federal taxable income a New York State bad debt deduction essentially using the pre -- 1987 rules. However, the percentage method is not allowed and such bank must subtract at least the amount determined using the actual experience method.

The provisions relating to large banks are effective for taxable years beginning after December 31, 1986 and sunsets for taxable years beginning after December 31, 1989.

Thrift Institution Bad Debt Provisions

New subsection (h) of Section 1453 allows a thrift institution (one subject to IRC Section 593) which computes all or a portion of its bad debt deduction using the percentage of taxable income method for federal income tax purposes to subtract from federal taxable income a New York State bad debt deduction. This bad debt deduction is nearly equal to the amount which was allowed as a deduction for federal income tax purposes prior to 1987. A taxpayer which subtracts a New York State bad debt deduction from federal taxable income must add to such income the following:

1. Any amount allowed as a deduction for federal income tax purposes pursuant to IRC Section 593(b)(1)(B) plus
2. 20 percent of the amount by which (i) the sum of the amount allowed a New York State bad debt deduction plus the amount allowed as a deduction for federal income tax purposes pursuant to IRC Section 593(b)(1)(A) exceeds (ii) the amount which would have been allowable as a deduction had the thrift institution maintained its bad debt reserve for all taxable years on the basis of actual experience.

The provisions relating to thrift institutions are effective for taxable years beginning after December 31, 1986.

Miscellaneous Provisions Affecting Entire Net Income

All references to the Internal Revenue Code of 1954 have been deleted. Technical conforming amendments are made to provisions of Article 32 pertaining to additions and deductions for depreciation in the computation of entire net income of a banking corporation. References to "recovery" in recovery property are deleted.

Effective for taxable years beginning after December 31, 1986 a banking corporation's federal taxable income is adjusted by adding back taxes paid under section 183, 184 and 186 of Article 9 and Article 9-A, in addition to the taxes paid under Articles 13-A and 32. This occurs when a cash basis corporation was subject to Article 9 or 9-A in the preceding year, paid that tax in the current year when it filed its return, and is taxable under Article 32 in the current year. Since the deduction is denied to a banking corporation, it is permitted to reduce federal taxable income by any credit or refund of such a tax if Article 32 did not allow a deduction for the tax.

Asset Tax Base

Chapter 817 amends Section 1455(b)(1)(v)(B) relating to the calculation of a banking corporation's net worth ratio for purposes of determining whether the taxpayer can compute its tax measured by assets by a reduced rate. The net worth ratio is the percentage of net worth to assets on the last day of the taxable year.

The term "Net Worth" means the sum of preferred stock, common stock, surplus, capital reserves, undivided profits, mutual capital certificates, reserve for contingencies, reserve for loan losses and reserve for security losses minus assets classified loss.

The term "Assets" means the sum of mortgage loans, non-mortgage loans, repossessed assets, real estate held for investment or development or resale, cash, deposits, investment securities, fixed assets and other assets (such as financial futures, goodwill and other intangible assets) minus assets classified loss. In no event can assets be reduced by reserves for losses.

Section 1455(b)(1)(v)(A) now provides that in determining whether 20 percent or more of a taxpayer's assets are interbank placements, the denominator is total assets, not taxable assets. This section also clarifies the definition of taxable assets. Taxable assets are defined as the average value of total assets reduced by (1) any amount of money or other property received from or attributable to amounts received from the Federal Deposit Insurance Corporation pursuant to Section 13(c) of the Federal Deposit Insurance Act, as amended, or the Federal Savings and Loan Insurance Corporation pursuant to Section 406(f)(1), (2), (3) or (4) of the Federal National Housing Act, as amended, and

(2) for taxpayers whose total assets are comprised of 20 percent or more of interbank placements reduced by the amount of interbank placements not to exceed \$500 million.

Other Miscellaneous Provisions

For purposes of computing the receipts factor of a banking corporation's allocation percentage the portion of net gains and other income from the trading and investment activities to be included in the numerator of the receipts factor is determined by multiplying such net gains and other income by a fraction the numerator of which is the value of New York trading and investment assets and the denominator of which is the value of to all such assets.

A taxpayer is now required to report to New York State, within 90 days after the final federal determination date, any change or correction in federal alternative minimum taxable income, as well as any change or correction in federal taxable income. The taxpayer must concede the accuracy of the determination or state where it is erroneous.

A banking corporation as defined in Section 1452(a)(9) of the Tax Law which is organized outside New York State and authorized to do business in New York State or a bank holding company which is organized outside New York State and authorized to do business in New York State, whose taxable year is less than 12 months, is now allowed to prorate the annual maintenance fee as provided in Section 181.2 of the Tax Law. Also, any Article 32 tax paid by a taxpayer is allowed as a credit against such fee.

Under Article 9-A of the Tax Law, each taxpayer which has subsidiary capital, investment income and/or investment capital determines the portion of such income and/or capital allocated to New York State by multiplying such income and/or capital by the issuer's allocation percentage. (See Tax Law Sections 210.3(b)(1) and 210.7) The issuer's allocation percentage of a bank or trust company organized under the laws of the United States, New York State or any other state is its alternative entire net income allocation percentage determined pursuant to Tax Law, Section 1454(c). The issuer's allocation percentage of a bank or trust company organized under the laws of a country other than the United States is determined by dividing gross income within New York State by worldwide gross income.

A new subsection (e) has been added to Section 1452 of Article 32 (definition of banking corporation). New (e) provides that except for a savings bank with a life insurance department, any corporation which is subject to Article 33 (franchise taxes on insurance corporations) is not subject to tax under Article 32.