

**DEPARTMENT OF TAXATION
2015 Fiscal Impact Statement**

1. **Patron** Gregory D. Habeeb
3. **Committee** House Finance
4. **Title** Bank Franchise Tax.

2. **Bill Number** HB 2217
House of Origin:
 X **Introduced**
 Substitute
 Engrossed
- Second House:**
 In Committee
 Substitute
 Enrolled

5. Summary/Purpose:

This bill would change the Bank Franchise Tax by requiring banks doing business within and without the Commonwealth to apportion their net capital to the Commonwealth using core deposits. Core deposits within the Commonwealth would be defined as deposits assigned to a branch location in the Commonwealth, deposits of customers located in the Commonwealth associated with a main office, and deposits of customers located in the Commonwealth that were opened using the Internet, the telephone, or other electronic means. The bill would also require affiliated banks to file a combined bank franchise tax return and authorize the use of alternative methods to equitably apportion the net capital of banks to the Commonwealth and its localities for purposes of the tax.

The provisions in the bill would become effective on January 1, 2016.

6. **Budget amendment necessary:** No.
7. **Fiscal Impact Estimates are:** Not available. (See Line 8.)
8. **Fiscal implications:**

Administrative Costs

The Department of Taxation ("the Department") considers implementation of this bill as routine, and does not require additional funding.

Revenue Impact

Most of the provisions of this bill codify current administrative practice and would have no impact on revenue. However, three provisions would affect revenue, but the amount is unknown.

1. The provision requiring an affiliated group of banks to file a combined return may increase or decrease the tax paid by the banks. While the combined taxable capital should be the same as the sum of separate taxable capital before

apportionment, the combined apportioned capital may be more or less than the sum of separate apportioned capital. Since localities impose a Bank Franchise Tax equal to 80% of the state tax, local tax revenue would be similarly increased or decreased.

2. The provision allowing banks to request, or the Tax Commissioner to impose, an alternative method of apportionment may increase or decrease the apportioned capital. Since localities impose a Bank Franchise Tax equal to 80% of the state tax, local tax revenue would be similarly increased or decreased.
3. To the extent that the definition of doing business has the effect of expanding the number of banks subject to Bank Franchise Tax, state and local revenue from the tax may increase. However, if these banks are currently filing Corporate Income Tax returns, then:
 - a. The state Corporate Income Tax revenue loss is likely to be greater than the state Bank Franchise Tax revenue increase because banks claim a credit of 80% of the state tax for local Bank Franchise Tax. However, this depends on the profitability of the bank (i.e., its return on capital).
 - b. The local Bank Franchise Tax revenue will be increased, but banks subject to the Bank Franchise Tax are exempt from BPOL tax. The net local revenue impact may be positive or negative.

The definition of “doing business” would apply to more out-of-state banks than are currently filing Bank Franchise Tax returns. Because several of the criteria, such as having property, payroll or offices in the state, would subject the bank to Corporate Income Tax, the definition would have the effect of shifting these banks from the Corporate Income Tax to the Bank Franchise Tax. However, the criteria based on receipts or deposits from Virginia residents obtained using the internet, telephone or other electronic means may be controversial. Banks have challenged similar provisions in other states as being unconstitutional. While the constitutionality has generally been upheld by the state courts that have addressed the issue, the U.S. Supreme Court has not yet ruled on the issue. It is not known whether out-of-state banks would voluntarily comply with the provision in this bill or litigate it.

9. Specific agency or political subdivisions affected:

Department of Taxation
Cities, counties and towns imposing a local Bank Franchise Tax

10. Technical amendment necessary: Yes.

It is suggested that a substitute bill be drafted to address these issues:

The use of the term “combined” may be confusing because it appears that the intent is to treat a group of affiliated banks as a single entity. This is the opposite of the meaning given the term in *Va. Code* § 58.1-442 for Corporate Income Tax purposes. It is

suggested that the word “consolidated” be substituted for “combined” wherever it appears in the bill.

The authority to use an alternative method of apportionment should apply to both capital apportioned to the state and capital apportioned among Virginia localities.

The definition of “core deposits” that excluded certificates of deposits greater than \$100,000 was originally adopted administratively in 1994 (Public Document No. 94-366, 12/8/94). At that time, deposits greater than \$100,000 were not insured by the F.D.I.C. and these “jumbo certificates” were marketed differently than certificates for less than \$100,000. Since then the F.D.I.C. has increased to \$250,000 the amount of deposits that it insures. Consideration may be given to correspondingly adjusting the definition of core deposits.

11. Other comments:

Background

The Virginia Bank Franchise Tax is imposed at a rate of 1 percent of the net capital of banks and trust companies. Cities, counties, and towns are permitted to impose a local Bank Franchise Tax not to exceed 80 percent of the state rate. If a bank has offices located in more than one county, town, or city, the tax imposed by each locality is subject to statutory apportionment based on the ratio which the total deposits located in each locality bear to the bank’s total deposits. The state Bank Franchise Tax liability is then reduced by the amount of Bank Franchise Tax paid directly to the counties, towns, and cities.

To the extent that they are subject to the Bank Franchise Tax, banks and trust companies are exempt from the Virginia Corporate Income Tax and the local Business, Professional, and Occupational License Tax. In addition, banks and trust companies that are subject to the Bank Franchise Tax can exclude certain tangible personal property from personal property taxation.

Virginia Bank Franchise Tax law does not currently provide a specific formula for apportioning the net capital of a bank that has offices located in Virginia and in one or more other states because it was enacted when banks were prohibited from opening branches across state lines. When federal law forced states to allow interstate branch banking, Virginia amended its banking laws in 1995 to allow it, but did not address the apportionment issue. Because the Bank Franchise Tax Act is silent on the apportionment issue, the Department administratively adopted an apportionment method in order to avoid the unconstitutional application of the tax to the entire capital of a multistate bank. Pursuant to Public Document 94-366, the Department allows multi-state banks to apportion net capital based on the ratio which the total deposits in Virginia bear to the bank’s total deposits, which is similar to the statutory method for apportioning capital among localities for purposes of the local Bank Franchise Tax.

In 2011, the Circuit Court for the City of Norfolk held that an out-of-state bank was subject to the Virginia Bank Franchise Tax even though its only office in Virginia did not accept deposits. The Court stated that the Department could adopt an alternative method for

apportioning an out-of-state bank's capital to Virginia, but did not address the issue of how such capital could then be apportioned among Virginia localities if there were offices in other localities.

Proposed Legislation

This bill would make three substantive changes to the Virginia Bank Franchise Tax law.

First, the bill would codify the administratively adopted apportionment method using core deposits and the use of an alternative method, if necessary, that was referenced in the Circuit Court opinion. Specifically, banks would be required to apportion net capital with and without Virginia by multiplying total net capital by a fraction, the numerator of which would be the bank's total core deposits within the Commonwealth and the denominator of which would be the bank's total core deposits everywhere. Core deposits within the Commonwealth would be defined as deposits assigned to a branch location in the Commonwealth, deposits of customers located in the Commonwealth associated with a main office, and deposits of customers located in the Commonwealth that were opened using the Internet, the telephone, or other electronic means.

Second, the bill would require a combined bank franchise tax return to be filed by banks that are members of the same affiliated group as defined under Internal Revenue Code § 1504(a)(1). The affiliated banks included on the combined return would be treated as a single entity for purposes of computing the amount of Virginia Bank Franchise Tax.

Third, the bill would clarify when an out-of-state bank that does not accept deposits at a Virginia branch would be subject to the Bank Franchise Tax. An out-of-state bank would be subject to Virginia Bank Franchise Tax if it is doing business in Virginia, which includes:

- Employing capital in the Commonwealth;
- Owning or leasing property worth \$50,000 or more in the Commonwealth;
- Maintaining an office or branch in the Commonwealth;
- Deriving receipts of \$500,000 or more from customers located within the Commonwealth;
- Incurring \$50,000 or more of payroll within the Commonwealth; or
- Accepting deposits of \$500,000 or more from customers located within the Commonwealth, which includes "direct banking deposits" associated with a main office or associated with accounts that were originated using the internet, the telephone, or other electronic means.

The bill would also require the Tax Commissioner to develop and publish guidelines implementing the provisions of this act. The guidelines would be exempt from the provisions of the Administrative Process Act.

The bill would be effective January 1, 2016, which would apply to returns due in 2016 for capital as of January 1, 2016.

cc : Secretary of Finance

Date: 1/24/2015 JPJ
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