

State Tax Issues and Trends

2011 Bank and Capital Markets Conference

Friday, November 4, 2011

Walter Doggett, E Trade

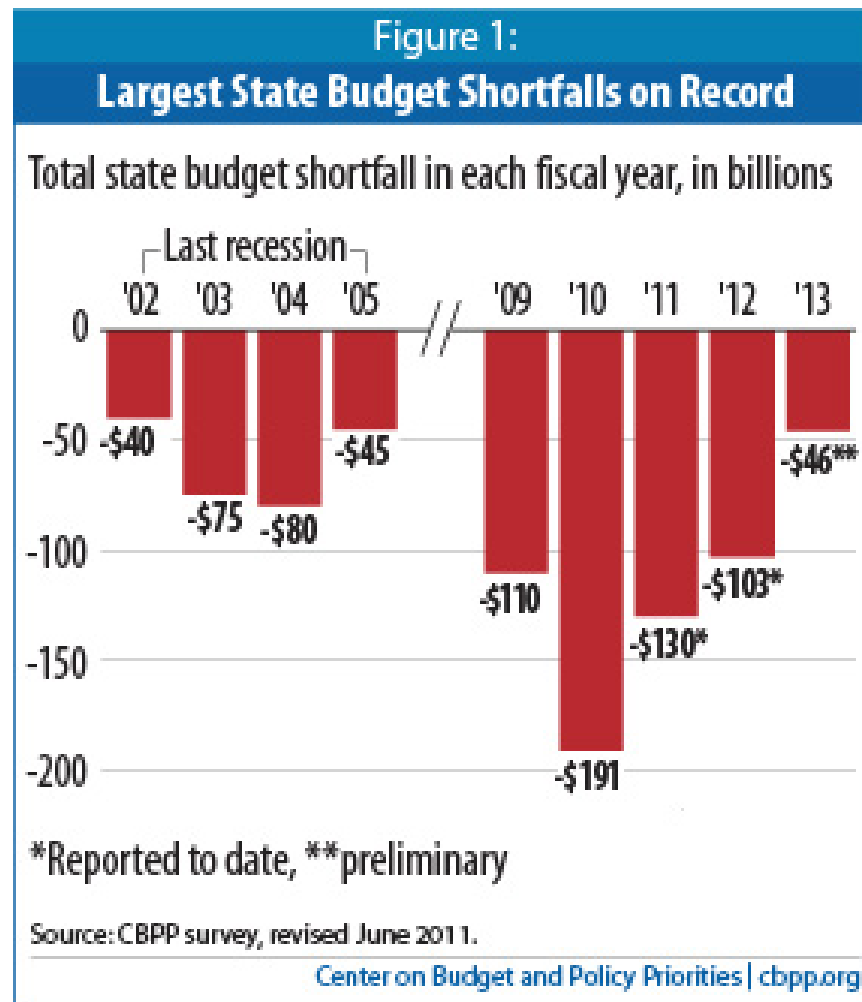
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SALT Issues and Opportunities

- Introductions
- Overview of States' Fiscal Condition
- Overview of State Tax Trends
- State Tax Developments
- Divergent "Financial Institution/Corporation" Classification
- Broker-Dealer Issues
- Asset Management Fees
- Mortgage Banking; Excess Inclusion Income
- FDIC-Assisted Transactions
- Texas Margin Tax

State Finances are Recovering, but Recovery Will Be Slow

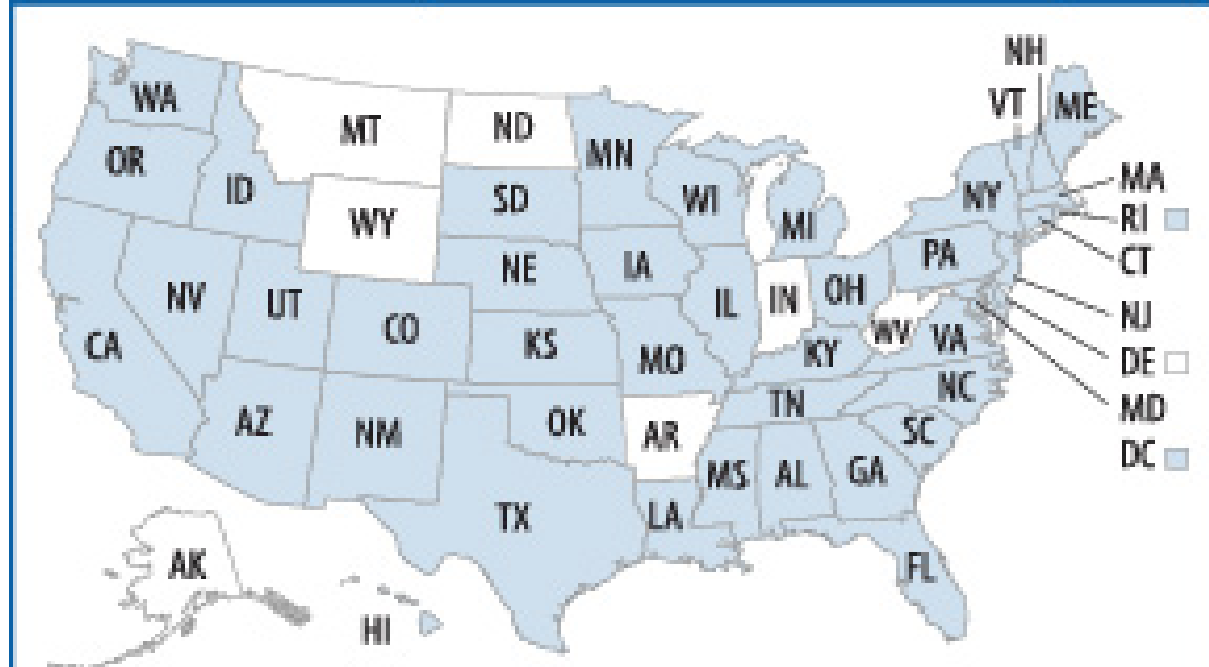


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State Finances are Recovering, but Recovery Will Be Slow

Figure 3:

42 States Have Projected Shortfalls for the Coming Year



Source: CBPP survey

Center on Budget and Policy Priorities | cbpp.org

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Overview of State Tax Trends

- Attributional Nexus/Economic Nexus
- Related Party Expense Addbacks
- Combined Reporting
 - D.C., Michigan, Rhode Island, Texas, Wisconsin
 - North Carolina (forced combination)
- Sales Factor Weighting
- Market/Customer Sourcing
- State Audit Activity/Aggressiveness/Penalties
- Tax Amnesties
- Retroactive Legislation/Judicial Decisions

Nexus

Attributional Nexus

- MI: *Vestax Securities Corp.* – MI Supreme Court held that taxpayer with independent registered representatives in state did not have substantial nexus for purposes of former SBT
- WA: *Lamtec Corp.* – WA Supreme Court held that out-of-state manufacturer that sent sales representatives to meet with its customers in WA had substantial nexus for purposes of the B&O tax – US Supreme Court denies cert

Nexus

Economic Nexus

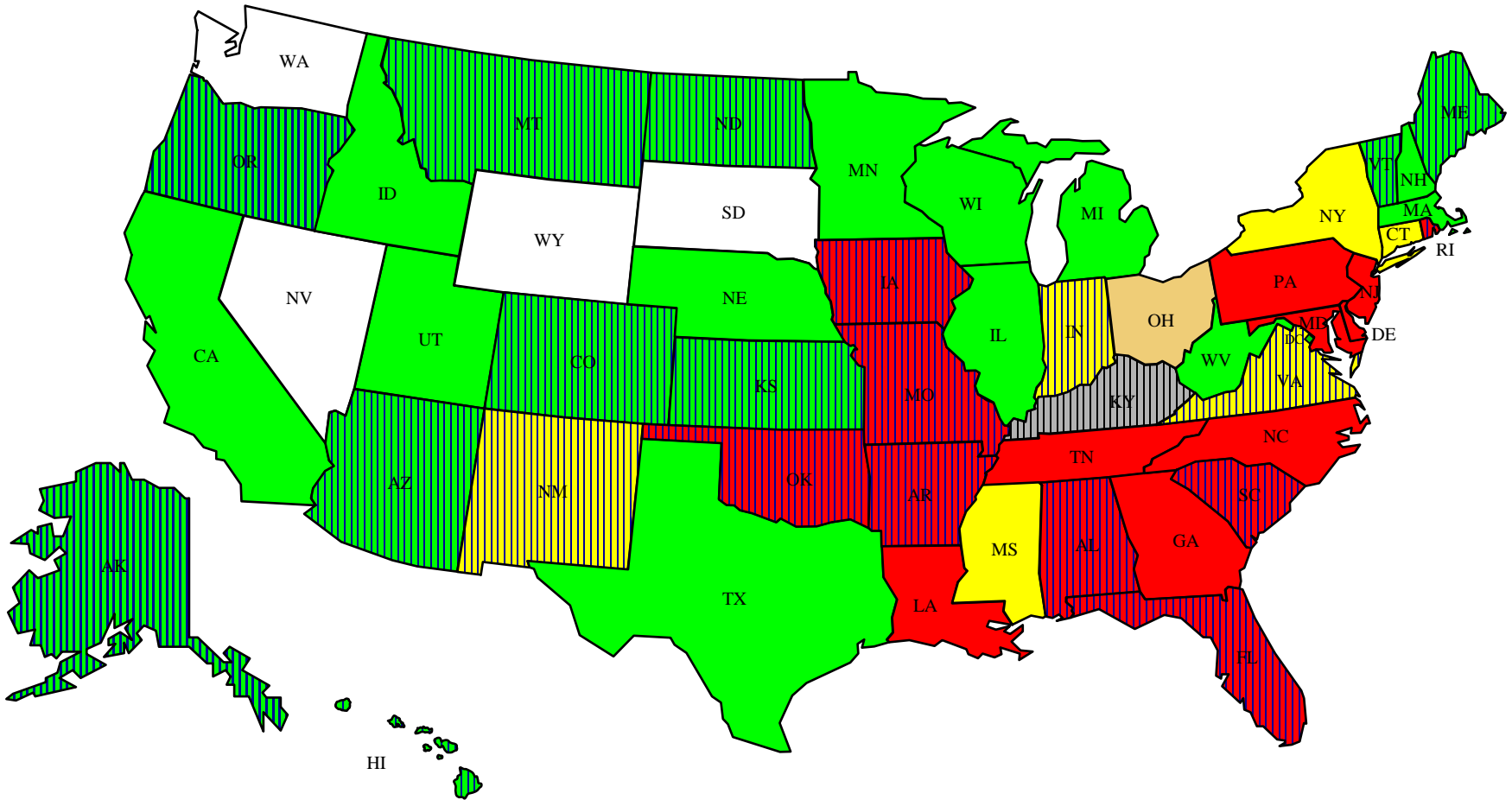
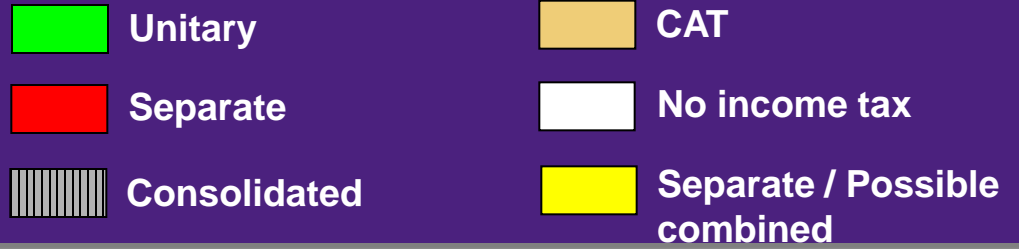
- Scope of Includible Transactions?
 - 'Loan' Volume v. Customer Accounts/Receivables?
- State Judicial Decisions
 - IA: *KFC Corp.* – US Supreme Court denies cert
- Administrative Guidance
 - NJ: TAM-6 clarifies that:
 - A financial business corporation, banking corporation, credit card company or similar business domiciled in another state is subject to NJ tax if it obtains or solicits business or receives gross receipts from sources within the state

Nexus

– State Legislation

- CT: For tax years beginning after 2009, a CT statute applies an economic nexus standard (Conn. Gen. Stat. § 12-216a)
 - For tax years beginning after 2010, statute amended to provide company is subject to tax if it derives income from sources within state **and** has substantial economic presence in state (H.B. 6652, Laws 2011)
- WA: Effective June 1, 2010, adopted economic nexus for purposes of B&O tax (Wa. Rev. Code §§ 82.04.066, 82.04.067)
 - Only applies to out-of-state entities that make sales to WA customers classified as service or royalty income
 - Sales include interest, fees, gains from trading securities, dividends and commissions
 - Trailing nexus provision

Filing Options (as of 10/5/2011)



Note that in many instances, state tax authorities may have power to mandate combined or consolidated reports. DC has changed to mandatory unitary combined reporting for tax periods beginning on or after Jan. 1, 2011.

State Tax Developments

- *Interaudi Bank F/K/A Bank Audi (USA)*, New York Division of Tax Appeals, Tax Appeals Tribunal, DTA No. 821659, April 14, 2011
 - Article 32 Combination of Investment Subsidiary
- FDIC-Assisted Transactions
 - California Adoption of IRC Sec. 597?
- 'MTC Apportionment Election' Litigation – CA, MI, TX
 - MTC Compact Exclusion of 'Financial Companies'
- 'Captive REIT Attacks'
 - State Legislative and Audit Attacks
 - Related Party Expense Disallowance – GA, WI, MTC Model
 - Favorable Treatment of 'Bank/Financial' REITs
- Sales/Use Taxation of 'Digital Products'
 - New York TSB-M-10(7)S, 07/19/2010

Divergent "Financial Institution/Corporation" Classification

- Divergent Definitions/Classifications
 - Specific Depository Institutions?
 - Specific List of Entities?
 - 'Financial Activity' Test?
 - 'Financial' Ownership?
- Divergent Tax Methodologies
 - Nexus (Economic Nexus Limited to Financials?)
 - Tax Base Modifications
 - Tax Rates
 - Combined Returns
 - Apportionment Computation
 - Factor Weighting
 - Sourcing Methods
 - Customer/Market State Focus
 - Broker-Dealers
 - Captive REIT Treatment

Broker-Dealer Issues and Opportunities

- "Financial Corporation" Classification
 - "Gross Income" Test
 - Substantial Competition with National Bank
 - California Chief Counsel Ruling
 - "Financial Ownership" – e.g., Illinois Treatment
- 'Costs of Performance' Analysis
 - 'Electronic Transactions'
 - Front Office v. Trading Desk v. Back Office
 - 'Customer Rep' Compensation Policy
 - Agency Trade Commission
- 'Gross v. Net' Receipts Apportionment – Principal Sales Trades
 - Administrative Policies
 - Use of Arbitrary %s – e.g., 60 – 40 Splits
 - Distortion Arguments (California, etc.)
- Economic Nexus

Asset Management Services

- "Financial v. Non-Financial" Classification
 - "Financial Ownership"
- Receipts Apportionment Sourcing
 - Market State Sourcing
 - Shareholder/Partner Sourcing
 - RIC Limitation?
 - California RIC Requirement
 - Hedge Fund/Investment Partnership Application?
 - Fund of Funds Application?
 - Throw-Out Rules
- Economic Nexus

Mortgage Banking

- "Financial v. Non-Financial" Classification
- Receipts Apportionment Sourcing
 - Market State Sourcing
 - Loan Sale Treatment
- 'SINAA' Studies
- Loan Production – FAS 91 Reporting
 - Deferred Income/Capitalized Costs
 - Gain on Sale Accounting
- Economic Nexus

Excess Inclusion Income – *Does Life Have To Be So Hard?*

- Excess Inclusion Income (EII) - IRC Sec. 860E(a)(1):
 - The taxable income ... shall in no event be less than the excess inclusion for such taxable year.
- Two Federal Taxable Income Computations
 - First compute taxable income without regard to EII, i.e., apply percentage based limitations, etc.
 - Second, compare amount to EII and EII 'overrides'.
 - Per Form 1120 Instructions, Line 28 does not reflect EII.
 - Override Line 30 (Page 1 will not foot).
 - Which taxable income computation does state pick-up?
 - First Computation? Line 28?

Excess Inclusion Income – *Does Life Have To Be So Hard?*

- Current Year Taxable Income?
 - California Legal Ruling 2009-01
 - California Information Letter June 23, 2009
 - New York *Delta Financial Corp. & Subs.*, March 29, 2007
- NOL Impact?
 - Follow Fed 'adjustment' method (IRC Sec. 860E(a)(3)? i.e., increase NOL by EII amount?
 - Override first calculation of state NOL? **Zero state NOL carryover?**
 - 'Post-apportionment' state NOL issue?
 - 'Line 30 piggyback' states?
 - Deferred tax asset impact?

Excess Inclusion Income – *Does Life Have To Be So Hard?*

- Compare to IRC Sec. 965(e)(2):
 - The taxable income ... shall in no event be less than the amount of nondeductible CFC dividends received during such year.
- Consider Treatment of Individual Taxpayers – Adopt Fed Agi? Follow Fed NOL Carryback?

FDIC-Assisted Transactions

- Federal Conformity Issues
 - IRC Sec. 338(h)(10)
 - IRC Sec. 597
 - California Issue
 - Systems Requirements?

Texas Margin Tax Litigation

- Litigation
 - Unconstitutional "Income Tax" ? - Texas Supreme Court, *Allcat Claims Service, L.P. and John Weakly*, No. 11-0589, August 22, 2011.
 - Expedited Review – Decision Required by Nov. 26, 2011.
 - "Gross Receipts" v. "Gross Income" v. "Net Income"
 - California FTB Notice 2010-02
 - 'MTC Apportionment Factor' Election' – Rich Products, Texas Supreme Court, *Allcat Claims Service, L.P. and John Weakly*, No. 11-0589
 - Tax Policy News April 2011 – "May Not Elect"

Texas Margin Tax Methodology

- Conflicting Statutes/Provisions?
 - Application of Franchise Tax Rulings
- Combined Return Methodology
 - Includes "Financial" and "Non-Financial" Entities
 - "Passive Entity" Planning/Pitfalls
- "Lending Institution" Classification
 - Bad Debt Deduction Issue
 - Interest Expense Deduction
 - "U.S. Government" Interest Deduction
 - Leasing Operations
 - Inclusion of Available For Sale Assets in Apportionment
- Receipts Apportionment Analysis
 - Numerator Analysis – 'Location of Payor' Sourcing
 - Gross v. Net Sales Receipts

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