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AN ALERT FROM THE BDO FINANCIAL INSTITUTIONS & SPECIALTY FINANCE PRACTICE

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SUBJECT

PENNSYLVANIA BANK SHARES TAX INCREASE PROPOSED

DETAILS

Pennsylvania Governor Tom Wolf's recently announced fiscal year 2015 - 2016 budget proposal includes tax provisions, which could repudiate the 2013 agreement between the commercial banks of Pennsylvania and the Commonwealth under the former Corbett administration. The provisions retain the concessions agreed to by the banks that have the effect of increasing taxable share value, but amend the Commonwealth's concession to a 0.89 percent rate of tax by raising the rate back to 1.25 percent, retroactively applied to January 1, 2014. This means that, should the bill pass as written, banks would likely be liable for almost an additional year of shares tax in the form of retroactive increases of 40 percent for each of the two years 2014 and 2015.

One of the principle objectives of the 2013 legislation, which overhauled the Bank Shares Tax, was to shift a large part of the shares tax burden to non-Pennsylvania-based banks. The change resulted in raising almost $50 million of additional revenue from them, according to Department of Revenue estimates. That figure can be expected to grow as the 2013 Act's threshold of $100,000 of Pennsylvania receipts requirement for nexus in the Commonwealth is dropped in the Wolf proposal to zero.

The Wolf proposal does nothing to affect the position of the Pennsylvania Department of Revenue that the goodwill deduction from taxable share value, which has been in the statute since 2008, does not apply to goodwill resulting from any acquisition other than that of a Bank Shares Tax payer. Therefore, according to the Department, it does not apply to acquisitions of former Corporate Net Income Tax payers, to acquisitions of Mutual Thrift Institutions Income Tax payers or to acquisitions of less than an entire bank – such as a branch acquisition.

The Wolf proposal does clarify that the goodwill subtraction applies not only to the calculation of the US Obligations subtraction from taxable share value but is also a separate subtraction from shares tax value.

In addition, the Wolf proposal appears to fix an error in the 2013 legislation text relating to the treatment of investment income for receipts apportionment purposes, by clarifying that Method 1, which essentially ignores investment receipts in determining the overall

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apportionment factor, is available to banks with investment income. However, the clarification does not expressly prevent the Department of Revenue from taking the position that such taxpayers nevertheless cannot avail themselves of Method 1, because they already adopted Method 2 in a "binding election," when Method 1 was not available to them. Additionally, changing from one Method to another requires the permission of the Department of Revenue.

The Wolf proposal changes the receipts definition from separate entity bank receipts as reported to the IRS, to consolidated bank receipts as presented on the Call Report. This may prevent banks with multistate operations organized through separate corporate subsidiaries from taking advantage of out of state apportionment on those operations, thereby impacting the ability to avoid or limit double-taxation.

In summary, the Wolf proposal overturns much of the previous Corbett administration's policy of a revenue neutral change to the Bank Shares Tax scheme, which spreads the burden among the affected banks more equitably. The bill, if passed, would create an across-the-board tax increase of more than 40 percent.

In an environment where community banks (who provide the majority of credit to small businesses) are still struggling to recover from asset losses, manage the cost of their increased regulatory burdens and achieve profit goals, the Wolf proposal may further exacerbate the challenging environment they are currently operating in.