JULY 2016
www.bdo.com

AN ALERT FROM THE BDO FINANCIAL INSTITUTIONS & SPECIALTY FINANCE PRACTICE

BDO KNOWS: FINANCIAL INSTITUTIONS & SPECIALTY FINANCE

PENNSYLVANIA GOVERNOR APPROVES BUDGET WITH BANK SHARES TAX CHANGES

SUMMARY

On July 13, 2016, Pennsylvania Governor Tom Wolf (D) approved into law H.B. 1198, Reg. Sess. 2015-2016 (Pa. 2016)—the final piece of the 2016-2017 Pennsylvania budget, which provides the tax legislation to fund the previously enacted spending plan. H.B. 1198 increases the Bank Shares Tax to 0.95 percent, extends the option to use Method I to source investment income receipts to taxpayers without trading receipts, includes receipts of non-bank subsidiaries in the apportionment factor, eliminates the $100,000 minimum receipts nexus threshold, makes a clarifying adjustment to the U.S. obligations subtraction and provides an exclusion for equity in a foreign bank. Most of these law changes take effect with the 2017 return due March 15, 2017.

DETAILS

Tax Rate Increase

H.B. 1198 enacts a six basis point increase in the Bank Shares Tax rate from 0.89 percent to 0.95 percent. The rate increase first applies to the 2017 return.

Method I Assignment of Investment Receipts

H.B. 1198 fixes an error in 2013 legislation to revise the Bank Shares Tax apportionment methodology so that banks with investment receipts, but no trading receipts, are now permitted to elect so-called "Method I" to source such receipts rather than being limited to the use of "Method II."[1] Method II sources investment and trading receipts to the state where they are effectively managed, which in most cases for Pennsylvania-based banks is Pennsylvania. Method I sources investment and trading receipts to Pennsylvania using a sourcing fraction comprised of all other receipts (e.g., receipts from loans, fees, etc.) attributable to Pennsylvania in the numerator, and all other receipts wherever derived in the denominator. Since a permanent "election" to use Method I or Method II on the current and future returns was originally required to be made on the 2014 Bank Shares Tax return, the fix in H.B. 1198 permits a "new" permanent election of one of the two methods as revised by H.B. 1198 to be made on the 2017 Bank Shares Tax return. Nonetheless, the option for a bank with no trading receipts to use Method I applies retroactively to Jan. 1, 2014.

Read more

HOW DO I GET MORE INFORMATION?

For more information or to speak to a partner, contact:

KEITH CENEKOFSKY, Partner
717-547-7330
kcenekofsky@bdo.com

RICH FARRELL, Partner
215-241-8963
rfarrell@bdo.com

FRANCESCO FROIO, Partner
215-241-8964
ffroio@bdo.com

GLENN JAMES, Partner
215-241-8959
gjames@bdo.com

JOE LACLAIR, Partner
315-427-1278
jlaclair@bdo.com

AL MOLIN, Partner
732-734-1047
amolin@bdo.com

STEVE MOREHART, Partner
610-568-9227
smorehart@bdo.com

BARRY PELAGATTI, Partner
610-331-3776
bpelagatti@bdo.com

YANA SQUERI, Partner
631-927-1047
ysqueri@bdo.com

Receipts of Non-Bank Subsidiaries

H.B. 1198 changes the definition of "receipts" for apportionment purposes to include all receipts of the parent bank and its non-banking subsidiaries. The 2013 legislation had defined relevant receipts to mean those of the bank alone, so as not to include receipts of non-banking subsidiaries, which, in addition to being subjected to bank shares tax by virtue of being included in bank equity, are already taxed in their own right as separate non-banking corporations. The requirement to include receipts of non-bank subsidiaries in the apportionment factor first applies to the 2017 return.

$100,000 Minimum Receipts Nexus Threshold

H.B. 1198 eliminates the minimum receipts nexus threshold of $100,000, which was rather low to begin with (e.g., New York has a $1,000,000 nexus threshold for corporate income tax purposes). At least based upon a strict reading of the law, this law change causes a non-Pennsylvania-based bank to be regarded as "doing business in Pennsylvania" if, for example, it makes a phone call to a Pennsylvania prospect and has $1 of receipts sourced to Pennsylvania. The elimination of the minimum receipts nexus threshold of $100,000 first applies to the 2017 return.

U.S. Obligations Subtraction

H.B. 1198 clarifies that the subtraction factor applied to bank equity based on holdings of U.S. obligations is to be applied to bank equity after, rather than before, the subtraction for goodwill. The clarification regarding the U.S. obligations subtraction applies retroactively to Jan. 1, 2014.

Exclusion for Equity in Foreign Bank

H.B. 1198 provides a special exclusion from bank equity for the equity in a subsidiary of a bank formed pursuant to section 611 of title 12 of the United States Code to engage in international or foreign banking/financial operations or carry on banking/financial operations in a dependency or possession of the United States. This exclusion will be phased in ratably over five years beginning with the 2019 Bank Shares Tax return.

BDO INSIGHTS

- Banks subject to the Pennsylvania Bank Shares Tax should assess what, if any, impact these law changes may have on their expense accrual for the year 2016.
- Given that the change in the law related to the method used to source investment receipts applies retroactively to Jan. 1, 2014, a bank that had elected Method II to source investment receipts on its 2014, 2015 and 2016 Banks Shares Tax returns should consider whether Method I would result in a lower amount of tax and, if the tax savings justifies, file a claim for refund.
- The ability of a bank with no trading income to elect the use of Method I to assign investment income should enable Pennsylvania-based banks to reduce their Pennsylvania apportionment and corresponding Bank Shares Tax.

  However, the requirement to include the receipts of non-bank subsidiaries in the apportionment factor could result in a higher Pennsylvania apportionment factor for a bank with Pennsylvania non-banking subsidiaries, and the clarification regarding the U.S obligations deduction could produce a smaller U.S. obligations subtraction.
- It is unclear why the equity in a foreign banking subsidiary would merit a subtraction from equity while the equity in a domestic non-banking subsidiary does not. This law change is most likely intended to accommodate the special interests of representatives of large banks operating in the Commonwealth.
- H.B. 1198 failed to include a clarification that allows for the subtraction of goodwill recorded in any acquisition from otherwise taxable bank equity. Currently, the Pennsylvania Department of Revenue's position is that the statute should be interpreted as limiting the subtraction to goodwill recorded as a result of the acquisition of another bank that was itself subject to the Bank Shares Tax, and denying the deduction for goodwill arising in the acquisition of a savings bank or a non-banking company.

Should you have any questions about the impact of the Bank Shares Tax changes, please contact Glenn James at 215-241-8959 or gjames@bdo.com or Todd Faciana at 215-636-5512 or tfaciana@bdo.com.

1 *See H.B. 465, Reg. Sess. 2013-2014 (Pa. 2013).*