

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Campbell Analyst: Gail Hall Bill Number: SB 1019

Related Bills: See Legislative History Telephone: 845-6111 Introduced Date: February 22, 2005

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Financial Institutions Transacting Trust Business

SUMMARY

This bill removes certain restrictions relating to foreign banks doing business in California.

PURPOSE OF THE BILL

The author's office has indicated that the purpose of this bill is to promote new business in California and encourage a competitive market.

EFFECTIVE/OPERATIVE DATE

This bill would become effective January 1, 2006. This bill specifies several transitional operative dates for its provisions.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

Current federal tax law defines a "bank" as a bank or trust company incorporated and doing business under the laws of the United States (U.S.), and a substantial part of the business of which consists of receiving deposits and making loans, or exercising fiduciary powers.¹ Banks are generally taxed like regular corporations with certain exceptions including, but not limited to, interest expense and bad debts. A foreign bank would be taxed on its income derived from U.S. sources.

Banks can be chartered either as national banks or state banks. The individuals who start a bank are free to choose the type of bank charter that best fits their needs. National bank charters are granted by the Department of the Treasury's Office of the Comptroller of the Currency in Washington, D.C., and in California, the California Superintendent of Banks regulates and supervises state bank charters. National banks are not affected by this bill since national banks follow federal regulations.

¹ Internal Revenue Code Section 581.

Board Position:	Department Director	Date
_____ S	_____ NP	
_____ SA	_____ NAR	
_____ N	_____ PENDING	Will Bush
_____ NA		5/24/05
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Current state law prohibits a foreign bank from conducting core banking business in this state except at a branch office established under federal and state law.² Examples of core banking business are receiving deposits, paying checks, and making loans.³ “Foreign,” when used with respect to “bank,” means a foreign (other nation) or foreign (other state) bank.⁴ “Other nation” means any nation other than the United States (U.S.) and “other state” means any state in the U.S. other than California.⁵

Banks are divided into three classes: 1) commercial banks, 2) industrial banks, and 3) trust companies. A trust company is a bank authorized to engage in a trust business. “Trust business” means the business of acting as executor, administrator, guardian or conservator of estates, or trustee.⁶ California has specific requirements relating to conducting a trust business as follows:

1. a California state bank may engage in trust business if the trust business is located at its California head office, branch, or authorized place of business,⁷
2. an “other state” bank may engage in trust business if authorized by the state, and
3. a foreign “other nation” bank may not engage in trust business but may exercise trust powers as a trustee for specific purposes.⁸

For taxable years beginning on or after January 1, 1996, banks and financial corporations apportion income to California based on a formula. The formula measures relative levels of business activity in the state using the amounts of the taxpayer’s property, payroll, and sales in California. These measures of activities are commonly called “factors.” The factors from both domestic and foreign activities are included in the calculation of the apportionment formula.

A bank that engages in trust business earns income from performing services. Receipts from the performance of fiduciary services, such as a trust business, are attributable to this state if the services are principally performed in this state. “Attributable to this state” means the income from services is classified as “California” sales for the apportionment formula.

A foreign bank, which files on a worldwide basis, would include its total income and factors in the calculation of state tax. A foreign bank that makes a water’s-edge election would include its income from U.S. sources in the calculation of tax.

A trust is subject to California tax if the corporate fiduciary is a resident of the state. A “resident” of the state means the corporate fiduciary conducts the major portion of its administration of the trust in California.

² Financial Code Sections 1750(a) and 3820.

³ Financial Code Section 3800(b).

⁴ Financial Code Section 139.2.

⁵ Financial Code Sections 139.3 and 139.5.

⁶ Financial Code Section 106.

⁷ Financial Code Section 1500.6.

⁸ Financial Code Section 1503.

THIS BILL

This bill would amend the Financial Code and:

1. allow foreign “other state” and “other nation” banks to transact trust business in California,
2. place restrictions on “other state” and “other nation” banks’ trust activities similar to restrictions currently placed on banks registered in California,
3. make other changes to terms and definitions relating to banks engaging in trust business, such as, independent trust company, office, branch, subject bank, controlling person, partial business unit, and other relevant terms, and
4. add “facility” to the list of places a bank may conduct trust business and allow “other state” banks to solicit trust business in California.

IMPLEMENTATION CONSIDERATIONS

This bill would not significantly impact the department’s programs and operations.

LEGISLATIVE HISTORY

AB 684 (Kehoe, 2001/2002) as introduced would have authorized credit unions to conduct trust business in the state. During session, the bill was significantly amended and the amendment relating to credit unions operating trust business was removed. The bill was held in the Senate Insurance Committee without further action.

AB 2070 (Kaloogian, 1997/1998) would have reduced restrictions on banks similar to this bill. The bill was held in Senate Appropriations Committee without further action.

OTHER STATES’ INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California’s economy, business entity types, and tax laws.

New York allows foreign banks and trust companies to conduct business with similar powers as domestic companies. *Florida* allows a state bank to establish a trust department, and *Massachusetts* allows state chartered trust companies to have trust departments and exercise trust powers. Research did not disclose how trust companies are treated in *Minnesota, Michigan, or Illinois*.

FISCAL IMPACT

This bill would not significantly impact the department’s costs.

ECONOMIC IMPACTRevenue Estimate

Based on data and assumptions discussed below, this bill would result in the following revenue losses.

Estimated Revenue Impact of SB 1019 As Introduced 2/22/05 [\$ In Millions]				
2005-06	2006-07	2007-08	2008-09	2009-10
a/	-\$1	-\$1	-\$2	-\$4
a/ Negligible loss of less than \$250,000.				

Revenue Discussion

By allowing "other state" and "other nation" banks to conduct trust business in California, this bill is expected to produce revenue losses relative to current law due to the loss of tax revenue on trusts. A national bank may provide trust services in any state, regardless of whether it maintains an office in the state. The revenue loss will occur as in-state business entities lose business to out-of-state companies and/or are able to assign the majority of their trustee operations out of California to remain competitive with out-of-state companies and avoid the tax on trust income.

Currently, trusts pay on average \$230 million annually in state income tax. The portion of this tax revenue attributed to financial institutions is approximately \$145 million. According to the Department of Financial Institutions, the value of trust assets generating trust tax revenue with state-chartered institutions is approximately one-ninth of the value of total trust assets with all institutions authorized to conduct trust business in California [$\$145 \text{ million} \times 1/9 = \16 million].

Losses above reflect an assumed reduction of one-quarter of the trust tax base (attributed to state-chartered institutions) by the fifth full year [$\$16 \text{ million} \times 25\% = \4 million]. Estimates for the initial years are phased in based on an assumption that trust business would be gradually transferred out-of-state. Estimates are rounded to the nearest one million.

ARGUMENTS

It may be argued that this bill would increase competition for trust business by allowing other states and nation banks to conduct trust business in California.

It also may be argued that this bill would decrease the number of trusts subject to California income tax. This is because a trust is not taxable in California if the fiduciary, or bank, is located outside of California. This bill would potentially increase the number of out-of-state banks that set up trusts for California taxpayers.

LEGISLATIVE STAFF CONTACT

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