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March 12, 2007  
 Chief Counsel Ruling 2007-1

Re: Request for Chief Counsel Ruling on Behalf of \*\*\*\*\*

Dear Mr. \*\*\*\*\*,

In your correspondence dated \*\*\*\*\*, you requested advice concerning the application of the test for determining whether a corporation will be treated as a "financial corporation" under Revenue and Taxation Code Section 23183 and its regulations.

FACTS

\*\*\*\*\* is a broker-dealer entity that is a single-member limited liability company. \*\*\*\*\* is wholly owned by \*\*\*\*\*. For federal income tax and California franchise/income tax purposes, \*\*\*\*\* is a disregarded entity. As such, \*\*\*\*\*'s income and activities are reported by \*\*\*\*\* , which has no other material income or activities. \*\*\*\*\* is a 'holding company' whose only asset is its interest in \*\*\*\*\* .

\*\*\*\*\* is registered as a "broker-dealer" with the Securities and Exchange Commission ("SEC") and is a member of \*\*\*\*\* and other exchanges. \*\*\*\*\* is also registered as an introducing broker with the \*\*\*\*\* , is a primary dealer in U.S. Government securities, and underwrites and/or deals in equity securities, corporate debt securities, mortgage and other asset-backed securities, U.S. Government agency obligations, state and municipal securities, money market instruments, and other financial instruments. \*\*\*\*\* also provides brokerage services, margin loans, and various investment banking and financial advisory services in connection with public offerings, mutual fund offerings, mergers and acquisitions, restructurings, private placements, loan syndications, loan trading, derivative product arrangements, and project financings. \*\*\*\*\* can also offer mutual fund investments and margin loans.

In regards to the specific activities at issue in this ruling request, you have represented that \*\*\*\*\* is conducting activities involving certain intangible assets that a national bank is not permitted to conduct and, as such, these activities would be considered "general" or "non-financial" activities under the test set forth in California Code of Regulations (CCR) Section 23183.

## ISSUE

Whether \*\*\*\*\*s income from non-financial activities can give rise to "financial income" for purposes of applying the gross income measurement test in determining "financial corporation" status because the activities produce income that is of the same character (e.g. interest income and gains on sales of intangibles) as income earned by a bank.

## LAW AND ANALYSIS

CCR Section 23183 (a) sets forth that a "financial corporation" means a corporation, except as provided in subdivision (b) of California Revenue and Taxation Code Section 23183, which predominantly deals in money or moneyed capital in substantial competition with the business of national banks.

Section (b) of the regulation provides definitions for the various requirements set forth in section (a). In pertinent part, subsection (b)(5) sets forth that the "business of national banks" means the businesses in which national banks are permitted to operate.

Because the "business of national banks" is defined in terms of the operation of a business, rather than simply the characterization of income, it is reasonable to conclude that simply earning income of the same character as a bank is not enough to have the activity that gave rise to the income deemed an activity in substantial competition with the business of national banks.

Further support for this interpretation is found in subsection (b)(4) which defines "substantial competition". This section, in part, provides that:

The *activities* of a corporation need not be identical to those performed by a national bank in order to constitute substantial competition, it is sufficient if there is competition with some, but not all, phases of the *business* of national banks...

(emphasis added)

This subsection provides further support for the conclusion that it is activities of the business that are determined to be financial in nature, not the character of the income.

## DETERMINATION

\*\*\*\*\*'s income associated with non-financial activities (the non-permissible national bank activities conducted by \*\*\*\*\*) should be considered non-financial income for purposes of applying the gross income measurement test for determining financial corporation status under regulation 23183.

Please be advised that the tax consequences expressed in this Chief Counsel Ruling are applicable only to the named taxpayer and are \*\*\*\*\*ed upon and limited to the facts you have submitted. In the event of a change in relevant legislation, or judicial or administrative case law, a change in federal interpretation of federal law in cases where our opinion is \*\*\*\*\*ed upon such an interpretation, or a change in the material facts or circumstances relating to your request upon which this opinion is \*\*\*\*\*ed, this opinion may no longer be applicable. It is your responsibility to be aware of these changes, should they occur.

This letter is a legal ruling by the Franchise Tax Board's Chief Counsel within the meaning of paragraph (1) of subdivision (a) of section 21012 of the Revenue and Taxation Code. Please attach a copy of this letter and your request to the appropriate return(s) (if any) when filed or in response to any notices or inquiries which might be issued.

Very truly yours,

Carl A. Joseph  
Tax Counsel III