



STATE OF CALIFORNIA
FRANCHISE TAX BOARD
Legal Branch
 PO Box 1720
 Rancho Cordova, CA 95740-1720
 (916) 845-5087 Fax (916) 845-3648

KATHLEEN CONNELL
 Chair
 DEAN ANDAL
 Member
 B. TIMOTHY GAGE
 Member

October 11, 2000

Chief Counsel Ruling
 2000-0236

Re: *****

Dear *****:

Your ruling request dated *****, has been referred to me for response. You offer the following facts and narrative description:

FACTS and NARRATIVE

As part of its loan sale arrangement, *****, retains the right to continue collecting the borrower's payments on the loans for a servicing fee ("loan servicing contract rights"). In addition to collecting and remitting loan payments, "servicing" responsibilities include accounting for principal and interest payments to investors and borrowers, and managing the payment of taxes and hazard insurance for borrowers from custodial accounts. *****, is compensated for servicing activities by retaining a portion of the interest payments on the loans that have been sold, as well as by collecting late charges and other fees. The servicing fee is typically computed based on a fraction of one percent of the principal balance of the loan, and is retained from the interest portion of the payments received from the borrowers. From payments made by borrowers, *****, remits to investors the full amount of the principal portion of the payment and the remainder of the interest portion of the payment (after deducting the servicing fee).

*****, on a non-recourse basis, substantially all of the mortgage loans that it sells pursuant to servicing agreements with Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Association (Freddie Mac), Government National Mortgage Association (Ginnie Mae), and various investors. In addition, *****, periodically purchases bulk-servicing contracts, also on a non-recourse basis, to service single-family residential mortgage loans originated by other lenders.

Chief Counsel Ruling 2000-0236
October 11, 2000
Page 2

***** , is proposing to separate the loan origination, acquisition, and sale business from the loan servicing business. The separation will occur through the transfer of servicing operations (people and assets), together with loan servicing contract rights, from ***** , to a limited partnership, owned by two intermediate corporate partners, each a wholly owned subsidiary of ***** . The limited partnership will elect to be treated as an association taxable as a corporation.

The limited partnership will not originate, invest in, hold, or acquire mortgage loans. The limited partnership will hold the loan servicing contract rights, tangible property related to servicing operations, and temporary investments of operating cash. More than 50 percent of the gross income of the limited partnership will be from loan fees related to the performance of mortgage servicing in accordance with the loan servicing contract rights.

ISSUE

Will the limited partnership be considered a "financial corporation" for California franchise tax purposes?

LAW

Revenue and Taxation Code section 23183(a) provides:

An annual tax is hereby imposed upon every financial corporation doing business within the limits of this state and taxable under the provisions of section 27 of Article XIII of the Constitution of this state, for the privilege of exercising its corporate franchises within this state, according to or measured by its net income, upon the basis of its net income for the next preceding income year at the rate provided under section 23186.

California Code of Regulations, title 18, section 23183 (a), defines a "financial corporation" as a corporation which "predominantly" deals in money or moneyed capital in substantial competition with the business of national banks.

Further, section 23183(b) provides the following definitions:

(b) Definitions.

(1) "Predominantly" means over 50% of a corporation's total gross income

is attributable to dealings in money or moneyed capital in substantial competition with the business of national banks. . . .

(2) "Deals in" means conducting transactions in the course of a trade or business on its own account as opposed to brokering the capital of others. A corporation which buys, sells, places or invests its own assets is dealing in moneyed capital.

(3) "Money or moneyed capital" includes, but is not limited to, coin, cash, currency, mortgages, deeds of trust, conditional sales contracts, loans, commercial paper, installment notes, credit cards, and accounts receivable.

(4) "In substantial competition" means that a corporation and national banks both engage in seeking and securing in the same locality capital investments of the same class which are substantial in amount, even though the terms and conditions of the business transactions of the same class are not identical. It does not mean there must be competition as to all phases of the business of national banks, or competition as to all types of loans or all possible borrowers. 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, or capital is invested in particular operations or investments like those of national banks.

(5) "Business of national banks" means the businesses in which national banks are permitted to operate.

The definition of "financial corporation" focuses on competition among financial businesses for investment capital. The danger sought to be avoided is that such capital might abandon the national banks for other financial enterprises if the latter were made relatively more profitable by preferential treatment. (See *Marble Mortgage Co. v. Franchise Tax Board* (1966) 241 Cal.App.2d 26, 35; *Crown Finance. Corp. v. McColgan*, (1943) 23 Cal.2d 280.)

Making mortgage loans constitutes dealing in moneyed capital. (See *Appeal of Southern Securities Corp.*, Cal. St. Bd. of Equal., Aug. 16, 1977.) Lending money is an activity commonly engaged in by national banks. (See *Appeal of Delta Investment Co., Inc.*, Cal. St. Bd. of Equal., April 6, 1978.)

A mortgage banker that originates, sells and services real estate mortgages is a financial corporation. A mortgage broker which acts merely as a third party bringing together the lender and the borrower and does not itself loan funds is not a financial corporation, even though it may service loans. The distinction is made in *Marble Mortgage Co. v. Franchise Tax Bd.*, supra, at 39.

It is undisputed that Marble's activities consisted in dealing in first deeds of trust on real property that were initially acquired in Marble's own name and through the use of funds supplied by Marble. . . . After Marble assigned the first deeds of trust to its various "purchasers," Marble retained a right to share in the interest payments on the loans, collected principal and interest on the loans and took all of the steps necessary to protect the security interest of the loans.

Marble's argument that it made loans only to support its "servicing business" is negated by the fact that the major portion of its gross income (51 to 60 percent) came from its activities prior to assignment, while the "servicing fees" accounted for only 34 to 42 percent of its gross income.

ANALYSIS

As described, the proposed limited partnership will hold the loan servicing contract rights, tangible property related to servicing operations, and temporary investments of operating cash. The limited partnership will not originate, invest in, hold, or acquire mortgage loans. More than 50 percent of the gross income of the limited partnership will be from loan fees related to the performance of mortgage servicing in accordance with the loan servicing contract rights. As such, the limited partnership will not "predominantly" deal in money or moneyed capital in substantial competition with the business of national banks.

HOLDING

The proposed limited partnership, owned by two intermediate corporate partners, each a wholly owned subsidiary of ***** , electing to be treated as an association taxable as a corporation, will not be considered a financial corporation as that term is used in California Revenue and Taxation Code section 23183 and California Code of Regulations, title 18, section 23183.

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

Chief Counsel Ruling 2000-0236

October 11, 2000

Page 5

This letter is a legal ruling by the Franchise Tax Board Chief Counsel within the meaning of Revenue and Taxation Code section 21012(a)(1).

Sincerely,

Edward J. Kline

Tax Counsel