

PricewaterhouseCoopers'

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# Tax hot topics

Moderator: Ken Busey

Partner, Washington National Tax Services,  
PricewaterhouseCoopers LLP

Panelists:

John A. Verde

Managing Director, State and Local Tax Practice,  
PricewaterhouseCoopers LLP

Jon Robin

Director, State and Local Tax Practice,  
PricewaterhouseCoopers LLP

Angela Wiesner

Director, State and Local Tax Practice,  
PricewaterhouseCoopers LLP

Tax hot topics

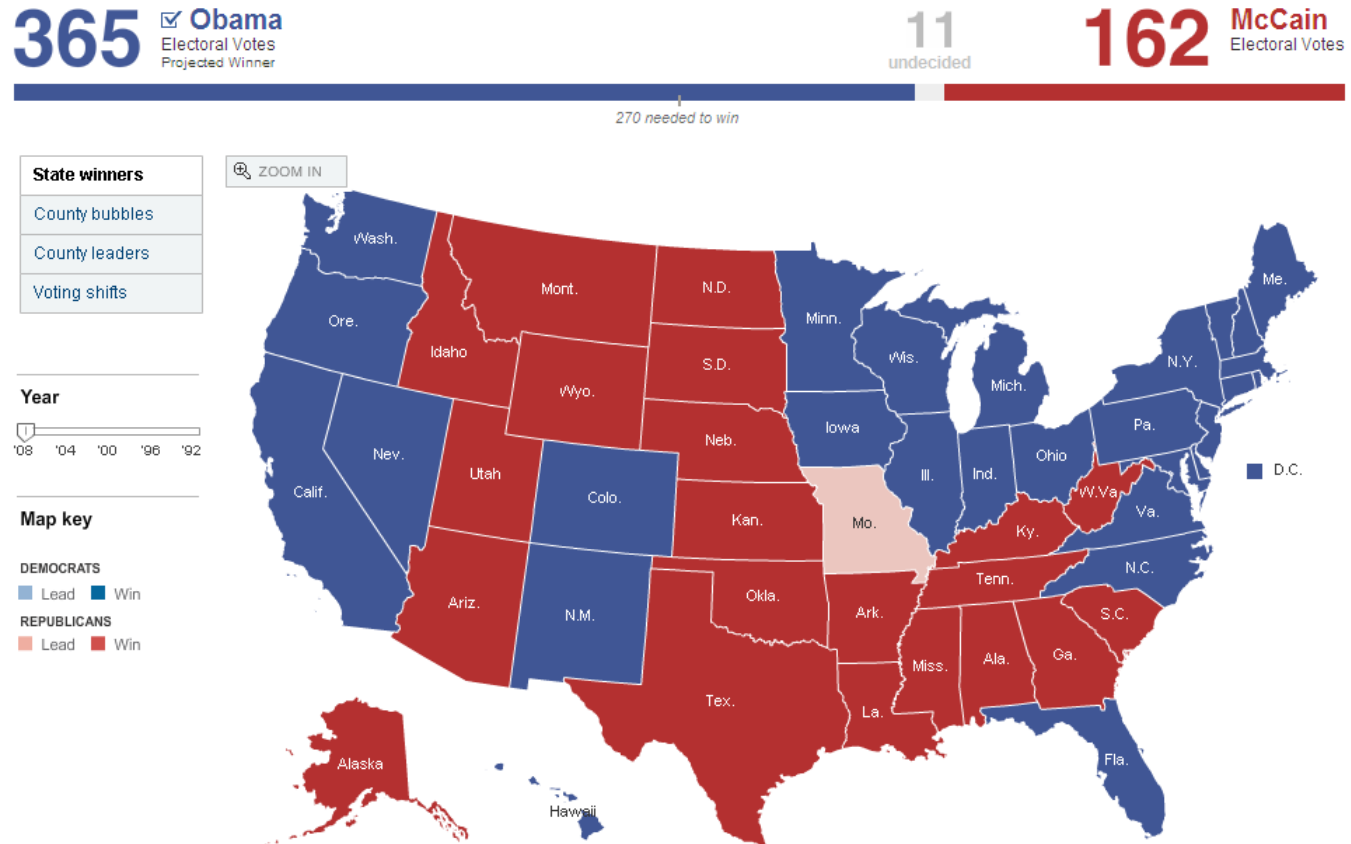
Federal Tax Update

## Federal Tax Update

- Legislative Review & Outlook
  - Analysis of election results
  - 2008 tax legislation
  - Key drivers for tax legislation in 2009 and 2010
- Crisis-Related Administrative Developments
  - §382 guidance
  - Executive compensation limits
  - Other guidance

# Tax hot topics

## 2008 Election: Presidential



\* Nebraska allocates some of its electoral votes on the basis of the results in each Congressional district. John McCain won four of the state's electoral votes, with Barack Obama winning one.

Source: The New York Times

# Tax hot topics

## 2008 Election: Senate

**57 Democrat**  
6 seats gained  
Majority Party

**3 undecided†**

**40 Republican**  
6 Seats lost

Includes 39 Democratic seats not up for election†

51 needed for majority

Includes 28 Republican seats not up for election

■ WIN ■ LEAD

### States Democrats expected to win easily

	Dem.	Rep.	% Rpt.
Ark.	79%	%	100%
Del.	65%	35%	100%
Ill.	63%	33%	99%
Iowa	63%	37%	100%
Mass.	66%	31%	100%
Mich.	63%	34%	100%
Mont.	73%	27%	100%
N.J.	56%	42%	99%
R.I.	73%	27%	100%
S.D.	62%	38%	100%
Va.	65%	34%	100%
W.Va.	64%	36%	100%

### States Democrats expected to win narrowly

	Dem.	Rep.	% Rpt.
Alaska	47%	48%	100%
Colo.	53%	43%	99%
La.	52%	46%	100%
N.M.	61%	39%	100%

### Battleground states

	Dem.	Rep.	% Rpt.
Minn.	42%	42%	100%
N.H.	52%	45%	100%
N.C.	53%	44%	100%
Ore.	49%	46%	96%

### States Republicans expected to win narrowly

	Dem.	Rep.	% Rpt.
Ga.	47%	50%	99%
Ky.	47%	53%	100%
Me.	39%	61%	100%
Miss. (S)*	45%	55%	100%

### States Republicans expected to win easily

	Dem.	Rep.	% Rpt.
Ala.	37%	63%	99%
Idaho	34%	58%	100%
Kan.	36%	60%	100%
Miss.	38%	62%	100%
Neb.	40%	58%	100%
Okla.	39%	57%	100%
S.C.	42%	58%	100%
Tenn.	32%	65%	100%
Tex.	43%	55%	100%
Wyo.	24%	76%	100%
Wyo. (S)*	27%	73%	100%

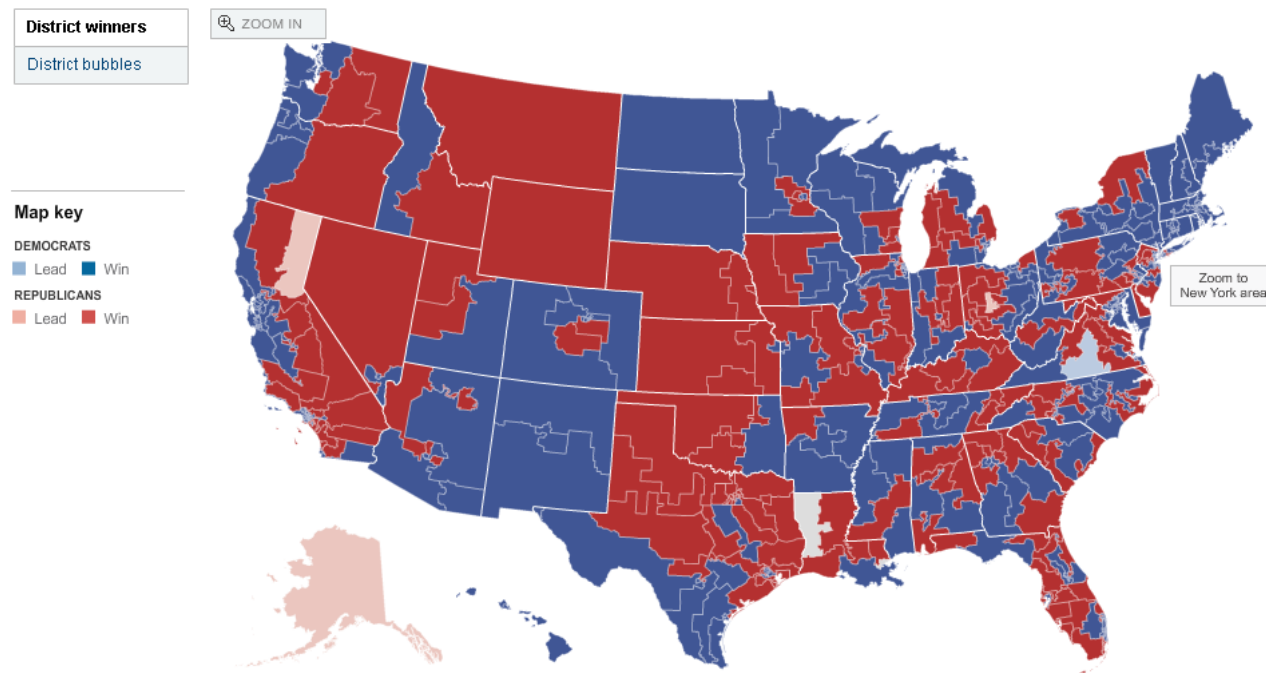
\* Special election

† Senate totals include two independents who caucus with the Democrats

Source: The New York Times

Tax hot topics

## 2008 Election: House



† Two House races in Louisiana - the 2nd and 4th Districts - will hold elections on Dec. 6.

Source: The New York Times

## Tax Legislation Enacted in 2008

### Economic Stimulus Act of 2008

- Individual Tax Rebates
- Enhanced Small Business Expensing
- Bonus Depreciation

### Heroes Earnings Assistance and Relief Act

- Mark-to-Market Tax on Individual Expatriates

### Housing Assistance Tax Act

- Refundable First-Time Homebuyer Credit
- AMT/R&D Credit Monetization
- Delay in Worldwide Interest Expense Allocation
- Credit Card Information Reporting
- Nonqualified Use of Principal Residence



## Tax Legislation Enacted in 2008

### Emergency Economic Stabilization Act

- Individual AMT Relief for 2008 (“Patch”)
- Tax Extenders, e.g., R&D Credit, Active Financing
- Energy Tax Incentives
- Oil and Gas Revenue Raisers, e.g., §199
- Additional Tax Relief, e.g., Disaster, Return Preparer Standard
- Taxation of Offshore Nonqualified Deferred Compensation
- Customer Basis Reporting by Brokers
- TARP-Related Tax Provisions
  - Extension of Mortgage COD Relief
  - Character of Bank-Owned GSE Preferred Stock
  - Executive Compensation Limits for TARP Participants

## Key Tax Policy Drivers in 2009-2010

- The Economy
- Obama Administration – Execution of Campaign Proposals
- Sunset of 2001 & 2003 Individual Tax Cuts After 2010
  - 2010 Mid-Term Congressional Elections
- Increasing Number of Taxpayers Caught by the AMT
- Growing Federal Budget Deficits
- Eroding International Competitiveness
- Non-Tax Issues with Potential Tax Implications
  - Health Care Reform
  - Climate Change

## Tax Options for Economic Stimulus

- Tax Rebates
- Eliminate Tax on Unemployment Benefits
- Eliminate/Reduce Tax on IRA & 401(k) Withdrawals
- Business Tax Credit for New Hires
- Expanded NOL Carryback Period
- Bonus Depreciation
- Expanded Small Business Expensing Limits
- Repatriation of Foreign Earnings
- Temporary Capital Gains Tax Relief
- Pension Plan Funding Relief

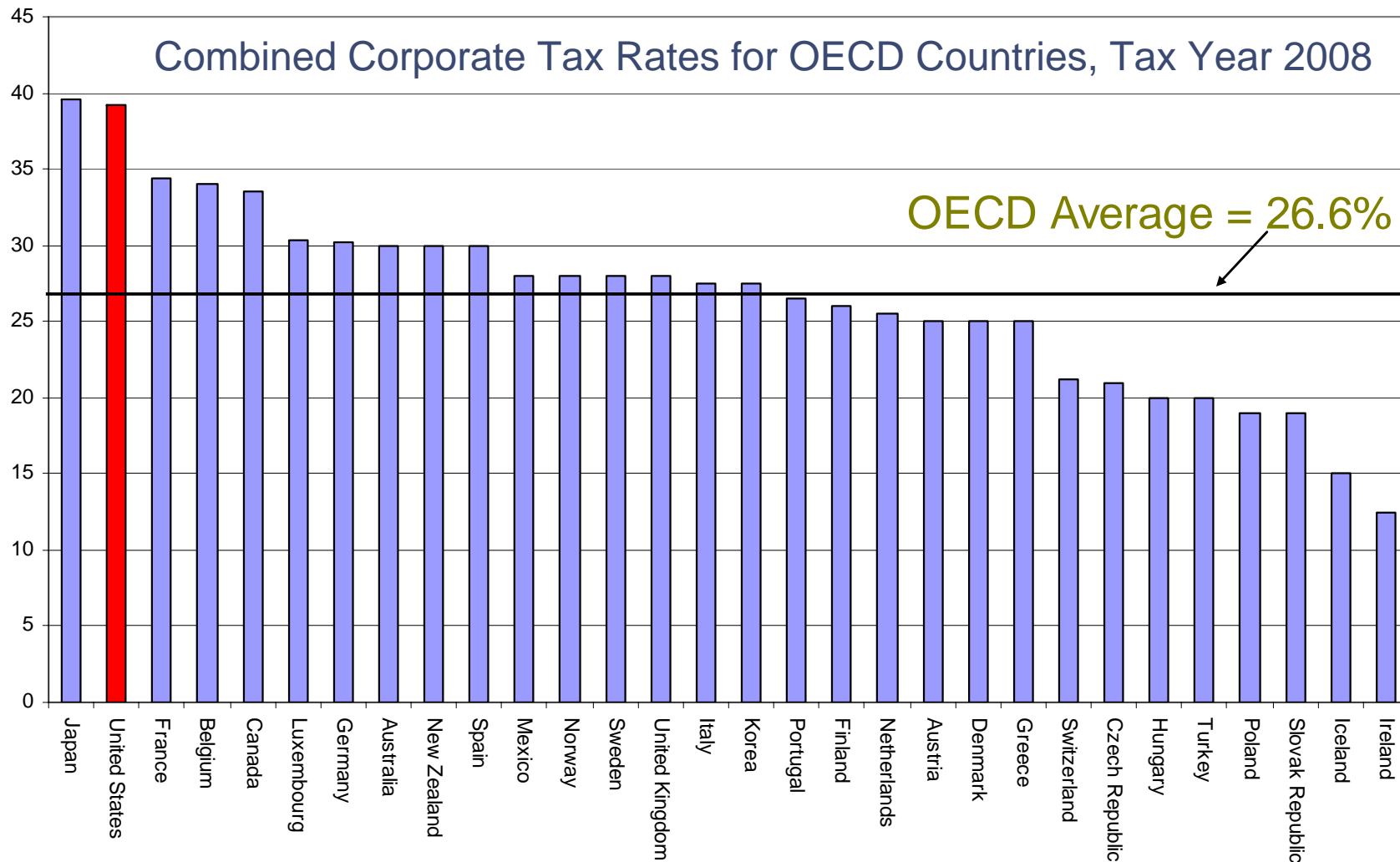
## Obama Campaign: Selected Individual Tax Proposals

- Make 2001 & 2003 rate cuts permanent for incomes under \$200k singles, \$250k couples
- Increase 33% and 35% tax rates to 36% and 39.6% for income over \$200k singles, \$250k couples
  - Effective date?
- Restore phase-out of personal exemptions (PEP) and phase-out of itemized deductions (Pease)
- Increase capital gains rate to 20% for top two brackets
- Freeze estate tax at 2009 levels – \$3.5m exemption, 45% rate
- Supports extending annual AMT “patch”

## Obama Campaign: Selected Business Tax Proposals

- Address provisions that “reward companies shipping jobs overseas”
- Provide tax credit for “patriot employers”
- Make the research tax credit permanent
- Reform subpart F deferral
- Codify the economic substance doctrine
- Tax carried interest as ordinary income
- Eliminate “CEO pay deductibility loophole”
- Address offshore tax havens

# International Comparisons Corporate Rate Competitiveness



## Recent IRS guidance

### Application of §382 to bank loan losses (Notice 2008-83)

- “Any deduction properly allowed after an ownership change ... to a bank [as defined by §581] with respect to losses on loans or bad debts ... shall not be treated as a built-in loss or a deduction that is attributable to periods before the change date”
- Widely seen as facilitating certain transactions, by effectively eliminating §382 limits on post-merger deductions
- Taxpayers may rely on notice, “unless or until there is additional guidance”
- Controversy, concern over government revenue loss

## Recent IRS guidance

### Other §382 guidance

- CPP preferred stock purchases and redemptions generally ignored, and not subject to anti-stuffing rule. *Notice 2008-100*
- Anti-stuffing rule changed from presumption to facts-and-circumstances, with safe harbors. *Notice 2008-78*
- Government acquisition of >50% interest does not trigger ownership change. *Notice 2008-84*



## Capital Purchase Program (CPP) Limits on executive compensation

- Must agree to apply new §162(m)(5) in any tax year in which Treasury holds equity or debt position
  - Deduction for annual compensation payable to CEO, CFO and next 3 highest-paid individuals (SEOs) limited to \$500k
  - No exceptions for performance-based or deferred comp
  - Deferred comp generally allocated over period during which individual is required to perform services

## Capital Purchase Program (CPP)

### Limits on executive compensation – cont'd

- Prohibition on golden parachute payments to CEOs
  - Generally applicable to involuntary terminations, or those in connection w/ bankruptcy, insolvency or receivership
  - Applicable to amounts exceeding 3X CEO's "base amount"
- Ban on incentive comp that encourages "unnecessary and excessive risk"
  - Required actions by Compensation Committee
- Clawback of bonuses/incentives paid to CEOs that are later found to have been based on materially inaccurate information

## Tax hot topics

### Recent IRS guidance

### Other guidance

- Relief for counterparty default under securities lending agreement, e.g., Lehman. *Rev. Proc. 2008-63*
- Temporary increase in §956 exclusion period, to 60 days. *Notice 2008-91*
- TARP assistance not treated as federal financial assistance under §597. *Notice 2008-101*
- Ordinary treatment of Fannie, Freddie preferred stock losses extended to bank-controlled affiliates. *Rev. Proc. 2008-64*

Tax hot topics

New York State and  
New York City

# Agenda

- Common Audit/Filing Procedures
- Responding to Notices
- Extending the Statute of Limitations
- Other Forms of Protest
- NYC Taxes – Tricks and Traps and Other Concerns
- GLB Transition Provisions

## Common Audit/Filing Issues

- Combination
  - NY is not unitary – yet
  - Pre-2006
  - Post-2007
- Expenses Attributable
  - TSB-M-95(2)C
- Liabilities Attributable
- Investment Income and Capital

## Other Areas of Note

- 86-272 – Protection applies to all bases of tax in NY
- NOLs must follow federal both in source and application years
- VDAs
  - New procedures in NYS
    - Loss of anonymity
    - Joint program with NYC discontinued
    - New on-line application process with limited look-back option

## Responding to Notices

- Processing Notices
- Consent to Field/Desk Audit
- Notice of Deficiency (90 days to respond)
  - Option for formal protest
- Notice and Demand
  - No formal protest rights



## Formal Protest Procedures

- Conciliation (BCMS)
- Administrative Law Judge (ALJ)
  - Determination of an ALJ is not binding on either party nor is it precedent setting
  - Can be appealed by either party to Tax Appeals Tribunal

## Formal Protest Procedures

- Tax Appeals Tribunal (TAT)
  - Binding on both parties unless appealed
  - Only taxpayer can appeal a TAT decision
  - Appealed to Courts:
    - NYS Supreme Court – Appellate Division
    - NYS Court of Appeals

## Informal Protests

- Allowed where formal petition rights have expired
- Request generally puts temporary stop on collection activity
- What if assessment is already in collections
  - Need to find out source of assessment and contact the person who generated it
  - Desk Audit
  - Field Audit
  - Processing Notice

## Audit Settlements

- Extending the Statute of Limitations
- Current atmosphere in NYS
- Shortcut an audit by offering to follow results of prior audit
- Enhance settlement opportunities by offering to bring audit current
- How to use leverage?
- When to go up the line?

## Other

- Filing a claim for refund
- Reporting a state change to NYC
- Statute of Limitations
  - 3 years, 2 years, additional 6 month if sign waiver
- When is audit closed
  - Signed consent?
- Corporate Partners new regulations
  - Gain on sale of partnership interest can tax free under certain circumstances (Reg. Sec. 3-13.7)

# New York City Taxes

Tricks and Traps and Other Concerns

Tax hot topics

## New York City Taxes – Tricks and Traps and Other Concerns

- Changes in Audit Administration
- Real Property Transfer Tax
  - Transfers of a controlling economic interest

## New York City General Corporation Tax and Bank Tax

- GCT comparable to NYS Art 9A; Bank Tax comparable to NYS Art 32, but recent state level changes have created compliance traps
  - Combination – GCT v. Art 9A
  - Treatment of captive REITs
    - May not be included in NYC combined group for GCT or Bank Tax purposes
    - Income flowing to NY parent fully exempt under GCT and 60% exempt under the Bank Tax
  - GCT apportionment
    - Three factor formula v. NYS single receipts factor
    - Not market-based for financial services receipts
  - City Bank Tax
    - Does not restrict grandfathered GCTs – NYC does
  - Federal S Corporations treated as C Corporations



## Other Areas of NYS Nonconformity and Reporting NYS Changes

- Voluntary Disclosure Agreements
  - Anonymous but no limitations on look back period
- No mandated electronic filings
- Mandatory reporting of NYS changes to NYC within 90 or 120 days

# New York Tax Considerations for BHC Conversions

## Conversion to Bank Holding Company

- Recently several non-bank financial services companies have converted to banking holding companies (“BHCs”) and have elected financial holding company (“FHC”) status
- New York State and City Tax Implications
  - *Impact on New York State and City filing status*
  - *Gramm-Leach-Bliley Act transitional provisions*
  - *The transitional rules were originally enacted in 1999 and have previously been extended 4 times by the New York legislature*
  - *The transitional rules are extended for taxable years beginning January 1, 2008 through January 1, 2010*

## Who's Subject to Article 32 Tax

### **Entities Subject to Article 32**

- Banks
  - *State chartered*
  - *Federally chartered*
  - *Incorporated in Foreign Country*
- Federal Savings Banks
- Bank Holding Companies
- Subsidiaries of Banks/Bank Holding Companies
- Gramm-Leach-Bliley Act Transition Rules

## Gramm-Leach-Bliley Transitional Provisions

### **NYS Tax Law § 1452(m)(1)**

- Corporations subject to tax under Article 9-A prior to January 1, 2008 shall continue to be taxable under Article 9-A for the next two years
- Banking corporations subject to tax under Article 32 prior to January 1, 2008 shall continue to be taxable under Article 32 for the next two years

## Gramm-Leach-Bliley Transitional Provisions

### **NYS Tax Law §1452(m)(2)**

- A corporation formed on or after January 1, 2008 and before January 1, 2010 may elect to be subject to tax under either Article 9-A or Article 32 for its first taxable year in which either:
  - *65% or more of its voting stock is owned or controlled by a FHC provided the corporation is engaged in certain activities described in the Federal Bank Holding Company Act of 1956, or*
  - *It is a financial subsidiary*
- Anti-Abuse provisions related to IRC §368

## Election to File on a Combined Basis

### **NYS Tax Law §1462(f)(2)(iv)(A)**

- A BHC may automatically elect to file on a combined basis with any 65% or more owned banking corporation for the first taxable year beginning before January 1, 2010 during which the BHC registers for the first time under the Banking Holding Company Act and elects to be a FHC
- Once the election to file on a combined basis has been made, the taxpayer must continue to file in such a manner
- If the above election has not been made, then permission must be obtained from the commissioner to file on a combined basis for any subsequent taxable year

## Gramm-Leach-Bliley Transitional Provisions

### **NYS Tax Law §1452(n)**

- For taxable years beginning on or after January 1, 2007, the transitional provisions will not apply to any corporation that elected to be taxable under Article 9-A that meets any of the following conditions:
  - *The corporation ceases to be a taxpayer under Article 9-A;*
  - *The corporation becomes subject to the \$800 fixed dollar minimum tax;*
  - *The corporation has no NYS wages or receipts, or is otherwise inactive;*
  - *65% or more of the corporation is acquired in a purchase under IRC §338(h)(3) unless the parties of the transaction are members of the same affiliated group;*
  - *The corporation is principally engaged in a new banking related business through acquisition of assets having an average value of greater than 40% of all its previously owned assets*
- The New York City Bank Tax does not contain similar triggering provisions as those under NYS Tax Law §1452(n)



## Article 9-A/Article 32 Significant Differences

	<i>Article 32 (Bank Tax)</i>	<i>Article 9-A (General Corporate Tax)</i>
Apportionment of investment income	Business Allocation Percentage	Investment Allocation Percentage
Apportionment factors – NYS	Three factor formula – 20% Payroll*, 40% Receipts, and 40% Deposits	Single receipts
Dividends from subsidiary capital.	60% exclusion of dividends received. No cost-to-carry disallowance	100% exclusion of dividends received. There is an “add-back” for expenses attributable to subsidiary capital
Interest from subsidiary capital	17% exclusion of gross interest received provided interest not deducted in a NYS/NYC tax return	100% exclusion of gross interest received. There is an “add-back” for expenses attributable to subsidiary capital
Bad Debts	Addback federal bad debt deduction under IRC § 166. Subtract New York bad debt deduction computed under reserve method	Same as Federal
Government securities	22 ½ % exclusion for gross interest received. No cost-to-carry disallowance	Generally subject to taxation as income from investment capital with a zero issuer’s allocation percentage taken into account in determining the investment allocation percentage

## Tax hot topics

# Article 9-A/Article 32 Comparison

	<i>Article 32 (Bank Tax)</i>	<i>Article 9-A (General Corporate Tax)</i>
New York State Tax Rate	7.1%	7.1%
New York City Tax Rate	9%	8.85%
Apportionment of investment income	Business Allocation Percentage	Investment Allocation Percentage
Apportionment factors – NYS	<p>Three factor formula – 20% Payroll*, 40% Receipts, and 40% Deposits</p> <p>*Numerator of the payroll factor is 80% of New York wages, salaries, and other compensations</p>	Single receipts
Apportionment factors – NYC	<p>Three factor formula – 20% Payroll*, 40% Receipts, and 40% Deposits</p> <p>*Numerator of the payroll factor is 80% of New York wages, salaries, and other compensations</p>	Three factor formula – equally weighted Property, Payroll, Receipts

## Article 9-A/Article 32 Comparison

	<i>Article 32 (Bank Tax)</i>	<i>Article 9-A (General Corporate Tax)</i>
Dividends from non-subsidiaries	Not available	50% exclusion of dividends received. No cost-to-carry disallowance
Dividends from subsidiary capital.	60% exclusion of dividends received. No cost-to-carry disallowance	100% exclusion of dividends received. There is an “add-back” for expenses attributable to subsidiary capital
Exclusion of interest from subsidiary capital	17% exclusion of gross interest received provided interest not deducted in a NYS/NYC tax return	100% exclusion of gross interest received. There is an “add-back” for expenses attributable to subsidiary capital
Interest income from government securities	22 ½ % exclusion for gross interest received. No cost-to-carry disallowance	Generally subject to taxation as income from investment capital with a zero issuer’s allocation percentage taken into account in determining the investment allocation percentage
Net operating Losses – NYS	Only available for losses incurred in 2001 forward	2 year carryback (limited to \$10,000) and 20 year carryforward but limited to federal amount
Net operating Losses – NYC	Not available	Same as NYS

## Article 9-A/Article 32 Comparison

	<i>Article 32 (Bank Tax)</i>	<i>Article 9-A (General Corporate Tax)</i>
Bad Debts	<p>Addback federal bad debt deduction under IRC § 166</p> <p>Subtract New York bad debt deduction computed under reserve method</p>	Same as Federal
Alternative Tax – NYS	<p>Greater of:</p> <ul style="list-style-type: none"> <li>• 3% of allocated alternative ENI, or</li> <li>• 0.01% of allocated assets (no cap)</li> </ul>	<p>Greater of:</p> <ul style="list-style-type: none"> <li>• 0.15% of allocated capital (cap of \$10,000,000), or</li> <li>• 1.5% of minimum taxable income,</li> </ul> <p>and</p> <ul style="list-style-type: none"> <li>• 0.09% of subsidiary capital</li> </ul>
Alternative Tax – NYC	<p>Greater of:</p> <ul style="list-style-type: none"> <li>• 3% of allocated alternative ENI, or</li> <li>• 0.01% of allocated assets (no cap), or</li> <li>• 0.26% of allocated issued capital stock</li> </ul>	<ul style="list-style-type: none"> <li>• 0.15% of allocated capital (cap of \$350,000),</li> </ul> <p>and</p> <ul style="list-style-type: none"> <li>• 0.075% of subsidiary capital</li> </ul>

## Article 9-A/Article 32 Comparison

	<i>Article 32 (Bank Tax)</i>	<i>Article 9-A (General Corporate Tax)</i>
Combination – NYS	Mandatory nexus combination for 80% or more owned banking corporations as well as discretionary combination in the event of distortion	Combination is required for 80% or more owned corporations in a unitary relationship that have substantial inter-corporate transactions
Combination – NYC	Same as NYS	Same as state except there is a presumption of distortion for substantial inter-corporate transactions rebuttable by showing the transaction was at arms-length
Investment Tax Credit – NYS	Available for property used in certain financial services activities	Available for property used in certain financial services activities
Investment Tax Credit – NYC	Not available	Not available

## Additional Considerations

- Article 32 v. Article 9-A is a new and additional tax consideration
- Future of NYS/NYC taxation of financial services industry
- BHC conversion considerations in other states

# Contacts

John Verde  
New York, NY  
(646) 471-1804

Jonathan Robin  
New York, NY  
(646) 471-0509

Angela Wiesner  
New York, NY  
(646) 471-3740

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