

ALABAMA DEPARTMENT OF REVENUE
REVENUE RULING 97-003

This document may not be used or cited as precedent. Code of Alabama 1975, §40-2A-5(a).

TO:

SUBJECT: Treatment of Corporate Reorganization for
Purposes of the Financial Institution Excise
Tax, Code of Alabama 1975, §40-16-1, et seq.

DATE: April 9, 1997

FACTS

Parent Corporation (hereinafter "Parent"), a Delaware corporation, is a registered bank holding company under the Bank Holding Act of 1956, as amended, qualified to do business as a foreign corporation in Alabama and with its principal place of business in Alabama. Parent, through its direct and indirect subsidiaries, conducts banking operations in seven separate states. Parent currently owns five separate second-tier bank holding companies which operate in five individual states. Each of the five second-tier holding companies is incorporated under the laws of the particular state in which it and its banking subsidiaries have their principal place of business. These second tier holding companies, in turn, own six separately

chartered banks operating in such states. In addition, Parent owns directly four separately chartered banks, two of which

have their principal places of business in Alabama, and two of which have their principal places of business in other states.

Pursuant to Code of Alabama 1975, §§40-16-1(1) and 40-16-3, Parent files an excise tax return on a consolidated basis with respect to the controlled group of financial institutions which are doing banking business within Alabama and of which it is the common parent corporation.

Effective June 1, 1997, Parent plans to undertake one of two alternative plans of reorganization for the purpose of simplifying and streamlining its organization, as described below. Parent will choose between Scenarios I and II on the basis of certain operational and regulatory considerations which have not been fully resolved as of the time this ruling is being issued.

SCENARIO I

In this scenario, Parent will cause each of its wholly owned, second-tier bank holding companies to be merged with and into Parent, with Parent being the surviving corporation (the "Upstream Mergers"). Parent intends that the Upstream Mergers will constitute liquidations of the second-tier bank holding companies under §§332 and 337 of the Internal Revenue Code of 1986, as amended (the "IRC") for purposes of federal income tax laws. In this phase of Scenario I, the second-tier holding companies will transfer all of their assets and all of their liabilities to Parent. Because the principal assets owned by the holding companies consist of the capital stock of the various banking corporations, as a result of the Upstream Mergers, Parent will obtain direct ownership of the stock of the banking corporations which Parent formerly held indirectly through the second-tier bank holding companies.

Immediately upon completion of the Upstream Mergers, each of the banking subsidiaries of Parent (including those banks formerly held by the second-tier bank holding companies) will be combined with and into a single national bank which will have its principal place of business in Birmingham, Alabama (the "Surviving Bank," as defined above). Parent intends that such combinations of the banking subsidiaries with and into the Surviving Bank (the "Bank Mergers") will constitute tax-free reorganizations (i.e., statutory mergers) for federal income tax purposes under IRC §368(a)(1)(A). Pursuant to the Bank Mergers the banking subsidiaries will transfer all of their assets and all of their liabilities to the Surviving Bank. The Bank Mergers together with the Upstream Mergers will constitute the "Reorganization" if Scenario I is undertaken.

Under Scenario I the corporate structure following the Reorganization will consist of a single bank holding company, Parent, with a single national banking subsidiary, Surviving Bank, each of which will have its principal place of business and commercial domicile in Alabama. The Surviving Bank will continue to carry on its own banking operations and those of all the banking subsidiaries of the former second-tier bank holding companies; these banking activities will be conducted both in Alabama and in six states other than Alabama.

SCENARIO II

Under an alternative plan, Parent will cause a new subsidiary bank holding company to be formed under the laws of Alabama (the "Alabama Holding Company"), and then will cause each of its other wholly-owned, second-tier bank holding companies to be merged with and into the Alabama Holding Company, with the Alabama Holding Company being the surviving

corporation (the "Holding Company Mergers"). Parent intends that the Holding Company Mergers will constitute tax-free reorganizations (i.e., statutory mergers) under §368 (a)(1)(A) of the IRC for purposes of federal income tax laws. In this phase of Scenario II, the holding companies will transfer all of their assets and all of their liabilities to the Alabama Holding Company and Parent will contribute to the capital of the Alabama Holding Company all of the capital stock of the banking subsidiaries directly owned by Parent.

Immediately upon completion of the Holding Company Mergers, each of the banking subsidiaries of the new Alabama Holding Company (including both those banks formerly held by the second-tier bank holding companies and those banks formerly held directly by Parent) will be combined with and into a single national bank which will have its principal place of business in Alabama (the "Surviving Bank," as identified above). Parent intends that such combinations of the banking subsidiaries with and into the Surviving Bank (the "Bank Mergers") will constitute tax-free reorganizations (i.e., statutory mergers) for federal income tax purposes under IRC §368(a)(1)(A). Pursuant to the Bank Mergers, the banking subsidiaries will transfer all of their assets and all of their liabilities to the Surviving Bank. The Bank Mergers together with the Holding Company Mergers will constitute the Scenario II Reorganization.

Under this Scenario II, the corporate structure following the Reorganization will consist of a single bank holding company, Parent, which will own 100% of the capital stock of a second-tier bank holding company (the Alabama Holding Company), which in turn will own 100% of the capital stock of a single national banking subsidiary, Surviving Bank. Each of these entities will have its principal place of business and

commercial domicile in Alabama. The Surviving Bank will continue to carry on its own banking operations and those of all the banking subsidiaries of the former second-tier bank holding companies; these activities will be conducted both in Alabama and in six states other than Alabama.

ISSUE

Whether any of the steps taken pursuant to the Reorganization, including the Upstream Mergers and the Bank Mergers under Scenario I, or the Holding Company Mergers and the Bank Mergers under Scenario II, will cause any of Parent, the Surviving Bank, the Alabama Holding Company, or any member of the consolidated group of financial institutions having Parent as the common parent to recognize net income for purposes of the financial institution excise tax.

LAW AND ANALYSIS

Code of Alabama 1975, §40-16-4, requires every financial institution to pay to the state annually an excise tax for the privilege of engaging in this state in the business of banking and of conducting a financial institution, as such term is defined in Chapter 16 of Title 40, Code of Alabama, and of conducting a business employing moneyed capital coming into competition with the business of national banks measured by its net income for the preceding taxable year at the rate of six percent of such income.

"Financial institution" is defined in §40-16-1(1) as including any person, firm, corporation and any legal entity whatsoever doing business in this state as a national banking

association, bank, banking association, trust company, industrial or other loan company or building and loan association, any other institution or person employing moneyed capital coming into competition with the business of national banks, regardless of what business form is used and whether or not incorporated and by whatsoever authority existing. The common parent corporation of a controlled group of corporations eligible to elect to file a consolidated excise tax return, in accordance with Section 40-16-3 also is considered to be a financial institution if such parent corporation is a registered bank holding company as defined by the Bank Holding Company Act of 1956, as amended. Parent is a "financial institution" because it is the common parent of a controlled group of corporations doing business as national banks and having branches, offices, and other locations within Alabama.

"Net income" is defined under Code of Alabama 1975, §40-16-1(2) as that income arising from the business the privilege to engage in which is taxed, computed by deducting from the gross income arising from such business, without any exclusions from or credit to such gross income, the total amount of certain deductions. However, there is no definition or explanation of the term "gross income arising from such business" in §40-16-1 through 40-16-8 Code of Alabama 1975.

As evidenced by the statutes' failure to define gross income, the financial institution excise tax statutes contain few details regarding the intended application of the tax to various situations. Accordingly, the Department of Revenue has made reference to the appropriate Alabama corporate income tax provisions to fill in such gaps.

For example, there are no less than four references to the Alabama income tax law and regulations in the Department's

financial institution excise tax regulations. Specifically, i.e., Department of Revenue Regulation §810-9-1-.01(4)(d)2. provides, with respect to the deductibility of taxes, "[i]n the case of corporate taxpayers which are members of affiliated groups which file consolidated income tax returns, the deductible tax will be allocated and apportioned based on the regulations provided under the Alabama income tax law."

In addition, the Alabama Department of Revenue Administrative Law Judge sanctioned the Department's use of the income tax three-factor formula of property, payroll and sales (or gross receipts) in apportioning a foreign financial institution's income to Alabama. The Administrative Law Judge noted that "neither the financial institution excise tax statutes (Title 40, Chapter 16), nor the Department's regulations relating thereto dictate how a financial institution operating in Alabama should apportion or compute its percentage of income earned in Alabama.... Rather, the Department as a matter of general policy requires all financial institutions to apportion net income to Alabama using the standard three-factor formula of property, payroll and sales." Navistar Financial Corporation v. State DOR, Docket No. INC. 93-249, 1994 WL 606208(Ala. Dept. of Rev.), Vol. 3, No. 1, Alabama Department of Revenue Administrative Law Quarterly, 3rd Quarter, 1994.

Clearly, both the Department and its administrative law division have made use of the Alabama corporate income tax laws and regulations in constructing and interpreting the provisions of the Alabama financial institution excise tax. As a consequence thereof, the Department should look to Alabama's income tax statutes in determining the tax consequences of Scenario I and Scenario II.

Code of Alabama 1975, §40-18-8(g) provides in pertinent

part:

In the case of a reorganization defined in 26 U.S.C. §368 (relating to definitions applicable to corporate reorganizations) ... the amount of gain or loss recognized shall be determined in accordance with 26 U.S.C. §§354, 355, 356, 361, 371 and 374.

IRC §368(a)(1)(A) provides that "a statutory merger or consolidation" qualifies as a tax-free reorganization for federal income tax purposes. In addition, Code of Alabama 1975, §40-18-8(i) incorporates federal law under IRC §332 into Alabama law, by providing that

no gain or loss shall be recognized on the receipt by a corporation of property on the complete liquidation of a subsidiary corporation when the requirements of 26 U.S.C. §332 (relating to complete liquidation of subsidiaries) are satisfied.

For Alabama corporate income tax purposes the Upstream Mergers will constitute tax-free, carry-over basis transactions which generate no taxable income to Parent or to the subsidiary holding companies, because the Upstream Mergers will constitute IRC §332 liquidations. The treatment of the Upstream Mergers under the financial institution excise tax should follow the corporate tax law of the state. The subsequent Reorganization under Scenario I will constitute a tax-free reorganization for state corporate income tax purposes under §40-18-8(g) by qualifying as an IRC §368(a)(1)(A) reorganization. The treatment of the Scenario I Reorganization under the financial institution excise tax should follow the corporate tax law of the state. Similarly, the Scenario II Bank Mergers together with the Holding Company Mergers constitute a tax-free reorganization under §40-

18-8(g). The treatment of the Scenario II Reorganization under the financial institution excise tax should also follow the corporate tax law of the state.

RULINGS

A. Scenario I. Assuming that the transactions constitute liquidations under IRC §§332 and 337 and qualify as tax-free reorganizations under IRC §368(a)(1)(A), the transactions to be undertaken in connection with the Reorganization described under Scenario I above--including the Upstream Mergers and the Bank Mergers-- will not, in and of themselves, cause either Parent, the Surviving Bank or any other member of the group of financial institutions with which Parent files a consolidated return under Chapter 16 of Title 40, Code, to recognize "gross income" for purposes of the Alabama financial institution excise tax; and

B. Scenario II. Assuming that the transactions constitute tax-free reorganizations under IRC §368(a)(1)(A), the transactions to be undertaken in connection with the Reorganization described under Scenario II above--including the Holding Company Mergers and the Bank Mergers--will not, in and of themselves, cause either Parent, the Alabama Holding Company, the Surviving Bank or any other member of the group of financial institutions with which Parent files a consolidated return under Chapter 16 of Title 40, Code, to recognize "gross income" for purposes of the Alabama financial institution excise tax.

The Commissioner of Revenue has recused himself from issuing this revenue ruling. In accordance with Code of Alabama 1975, §40-2-44, the Commissioner has assigned the Assistant Commissioner of Revenue the duty of issuing this ruling.

ALABAMA DEPARTMENT OF REVENUE

By: _____
GEORGE E. MINGLEDORFF III
Assistant Commissioner

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