COMMONWEALTH of VIRGINIA

Department of Taxation

TO: Commissioners of the Revenue & Other Local Officials

FROM: C. Keven Wright
Director of Special Taxes and Services

SUBJECT: Bank Franchise Tax Refunds for Branch Banking and Trust Company
Tax Years 2012-2014

DATE: February 27, 2020

I wanted to make you aware of a large refund request that may impact your locality. Branch Banking and Trust Company filed revised Bank Franchise Tax (BFT) returns for tax years 2012 through 2014. Virginia Tax conducted an audit of the amended returns. Branch Banking and Trust Company appealed the audit to the Tax Commissioner. The ruling is attached for your review. The table below indicates the original refunds requested and the approved refunds, exclusive of interest, based on the Determination.

Original Refund Requested	Adjusted Amended Refund
2012 - $3,906,439	$3,590,372
2013-$3 ,569,940	$3,050,539
2014- $4,662,551	$3,679,331
Total- $12,138,930	$10,320,242

Attached you will find a Local Tax Apportionment Schedule for 2012 – 2014, with the Department's computation of the local refunds.

If you have questions, please contact Becky Akers at rebecca.akers@tax.virginia.gov or at (804) 225-4410.

COMMONWEALTH *of* VIRGINIA

Department of Taxation

October 1, 2019

Mr. David M. Vistica
Washington National Tax
Deloitte Tax LLP
555 12th Street, N.W., Suite 400
Washington, D.C. 20004

Re: § 58.1-1824 Application: Bank Franchise Tax
Branch Banking and Trust Company

Dear Mr. Vistica:

This is in response to your letter in which you seek correction of the bank franchise tax (BFT) assessments issued to Branch Banking and Trust Company (the "Bank") for the 2013 and 2014 tax years and protective claim for refund for the 2012 through 2014 tax years. I apologize for the delay in responding to your appeal.

FACTS

For the tax years at issue, the Bank had investments in numerous subsidiaries that were reported in the Bank's official report of condition (the "Call Report"). The Bank timely filed amended BFT returns for the taxable years at issue, reporting a significant increase in its deduction for retained earnings and surplus of subsidiaries and requested refunds.

Under review, the Department requested additional documentation concerning the deductions for the surplus of subsidiaries. Based on the additional documentation, the Department granted deductions that were less than originally claimed. The Department also increased taxable capital on the 2014 return. The refunds were denied and assessments were issued for the 2013 and 2014 tax years.

The Bank filed a protective claim for refund, contending it had correctly reported its capital on the 2014 return and the deductions on its amended returns. The Bank also asserts the Department assessed the 2013 tax year beyond the statute of limitations. Further, if relief is not granted on the issue of the deduction, the Bank claims the Department failed to allow a historic rehabilitation tax credit to which it was entitled.

DETERMINATION

Statute of Limitations

Pursuant to *Virginia Code* § 58.1-104, the Department generally has authority to issue an assessment within three years of the due date of a timely filed return. Under *Virginia Code* § 58.1-1207, the 2013 BFT return was due March 1, 2013. Thus, the Department had until March 1, 2016, to issue an assessment. The 2013 assessment was issued in February 2017, beyond the statute of limitations.

Total Equity Capital

The BFT is imposed on the net capital of a bank. *Virginia Code* § 58.1-1205 provides the computation for determining a bank's net capital. There is no provision under Virginia statute that requires or permits banks to combine capital among affiliated banks for purposes of determining its BFT liability. Instead, each bank must make a separate determination of its capital.

For the 2014 tax year, the Department adjusted the Bank's "total equity capital" to equal the amount reported on the Call Report. While Title 23 of the Virginia Administrative Code (VAC) 10-330-20 B 7 starts the BFT computation with total equity capital as reported on the Call Report, the Department has recognized that changes in United States Generally Accepted Accounting Principles (GAAP) and federal banking regulations have included items reported in a bank's equity beyond those items identified in Virginia's statute. See Public Document (P.D.) 05-165 (12/5/2005).

Under *Virginia Code* § 58.1-1205, the computation of net capital begins "by adding together its capital, surplus, undivided profits and one half of any reserve for loan losses net of applicable deferred tax . . . ." Title 23 VAC 10-330-20 defines "gross capital" to mean "the total of capital stock, surplus, and undivided profits and one half of any reserve for loan losses net of applicable deferred tax . . . ." Under the regulation, the gross capital of a bank is computed by adding the following accounts as reported on the Call Report: (1) preferred stock, (2) common stock, (3) surplus, (4) undivided profits and reserve for contingencies and other capital reserves, and (5) 50% of reserve for loan losses reduced by deferred tax. Under Virginia's regulation, any amounts not included in these five categories are not included in a bank's computation of total equity capital.

For the 2012 through 2014 tax years, the Bank included "noncontrolling (minority) interests in consolidated subsidiaries" in computing its total equity capital reported on its Call Reports. The Bank argues this line was created as a result of the reclassification of liabilities related to minority interests in relegated entities from the liability section of the balance sheet. According to the Bank, it was required to report a lower-tiered subsidiary as a noncontrolling interest because it was held outside the consolidated group included in the Call Report.

Financial Accounting Standards Board (FASB) Statement No. 160 made a number of amendments to Accounting Research Bulletin (ARB) 51 with regard to consolidating financial statements of related entities. Included in the amendments was a change in the way noncontrolling interests in other entities were reported in the financial statements. Instead of reporting the noncontrolling or minority interests in the liability section of the balance sheet, FASB Statement No. 160 began requiring entities to report noncontrolling interests in the consolidated statement of financial position with equity but separate from the parent's equity. Under the provisions of FASB Statement No. 160, the total equity capital reported on the Call Report included a separate item in its equity section for "noncontrolling (minority) interests in consolidated subsidiaries." The description of the equity accounts included in determining a bank's capital subject to BFT does not include noncontrolling or minority holdings in a subsidiary.

Deduction for Surplus

Under GAAP, banks are required to include majority-owned subsidiaries in a consolidated Call Report. Accordingly, a Call Report filed by a bank may include the bank and its subsidiaries. Before consolidation, a parent bank will include the investment in its subsidiary as an asset. The subsidiary reports a corresponding equity owned by the parent bank in the equity section of its balance sheet. When the entities are consolidated, an elimination adjustment is made to offset the intercompany transaction. In the elimination, the parent bank's asset will be offset by the subsidiary's equity owned by the bank.

Virginia Code § 58.1-1206 A 4 permits a deduction equal to the "amount of retained earnings and surplus of subsidiaries to the extent included in the gross capital of the bank." Title 23 VAC 10-330-30 E explains that the intent of the deduction is to remove the amount of increase in the bank's recorded investment in its subsidiaries resulting from undistributed earnings of such subsidiaries from the gross capital of a bank. This reduces the possibility that the bank would be taxed on the activities of its subsidiaries. Under the regulation, the deduction is limited to the amount included in gross capital that represents the undistributed earnings of its subsidiaries during the period of the bank's investment in such subsidiaries.

For reporting purposes, the regulatory requirements applicable to the Call Report conform to GAAP. Under ARB No. 51, retained earnings of a purchased subsidiary at the date of acquisition are not included in consolidated financial statements. Consequently, the only undistributed earnings of a subsidiary that should be included in a bank's consolidated financial statement would be the subsidiary's retained earnings during the period of the bank's investment.

Such increases are generally reflected in a subsidiary's undivided profits or retained earnings. In some instances, however, the increase may be reflected in the subsidiary's surplus. As such, the deduction is permitted for the subsidiary's retained earnings and surplus.

Pursuant to Title 23 VAC 10-330-20 B, "surplus" is defined as the amount shown on the Call Report including "reserves for contingencies and other capital account reserves." For purposes of the Call Report, the surplus account includes capital contributions, adjustments arising from treasury stock transactions, and any amount received for common stock in excess of its par value.

Unlike retained earnings, a subsidiary's surplus at the date of acquisition is not eliminated in consolidated financial statements under GAAP. Consequently, the clear language of the statute permits a deduction for any amount of a subsidiary's surplus included in the Call Report of a bank. Such surplus, including reserves, treasury stock, and amounts paid in excess of par, should be readily identifiable on the subsidiary's year end financial statements. See P.D. 06-69 (8/18/2006).

The Department denied the deductions for surplus because Title 23 VAC 10-330-30 E restricts the deduction to undistributed earnings. In addition, the deduction reported on the 2014 return far exceeded the amount reported on the Call Report.

The term "undistributed earnings" is not defined for BFT purposes. Generally, the term "undistributed earnings" is used along with a number of terms to describe retained earnings, which are earnings or profits that are not paid as distributions to the entity's owners. The Virginia Supreme Court has used the terms "undistributed earnings" and "retained earnings" interchangeably. See *Segaloff v. Segaloff*, 59 Va. Cir. 55, 2002 Va. Cir. LEXIS 131 (2002). *Virginia Code* § 58.1-1206, however, permits a deduction for surplus in addition to retained or undistributed earnings. See also P.D. 06-69 (8/18/2006).

As to the amount of the deduction claimed by the Bank, *Virginia Code* § 58.1-1206 A 4 limits the deduction to the extent retained earnings and surplus are included in the gross capital of the bank. In conjunction with its review, the Department requested the Bank to provide a reconciliation of its deduction to amounts reported on the Call Report. The reconciliation provided by the Bank indicated that a significant amount of the deduction for retained earnings and surplus claimed on its amended returns had been eliminated before being reported on the Call Reports. In accordance with the statute, the Bank would not be permitted to deduct retained earnings and surplus not included in gross capital.

Historic Rehabilitation Tax Credit

In 2009, the Bank received a Historic Rehabilitation Tax Credit (the "Credit") from a pass-through entity. In subsequent years, the Bank became eligible to claim additional Credits received through various pass-through entities.

Under *Virginia Code* § 58.1-339.2, any individual, trust, estate, or corporation is entitled to the Credit equal to 25% of eligible expenses. Credits granted to partnerships are allocated to the partners either in proportion to their ownership interest or as agreed. The credit may be carried over for up to 10 tax years.

As permitted under the statute, the portion of the Credit that was not used on the 2010 BFT return was carried forward to 2011 and 2012. Credits earned in subsequent taxable years were likewise carried forward to 2012, 2013 and 2014 and claimed on the Bank's original BFT returns. When the Bank filed amended returns, the state BFT tax liability was reduced to $0. As a result, the Bank had no BFT liability on which to apply the Credits that had been carried forward. Thus, the Bank did not report any Credit on the amended returns.

The Bank asserts the Department has not reflected available Credits against the assessments made for the 2013 and 2014 tax years. A review of the audit reports confirms the Department failed to adjust Credit carryovers to reflect the full amounts that were eligible to be claimed in its audit findings and resulting assessments.

When the Bank amended its deduction of retained earnings, it also amended its claims for the Credit in accordance with the resulting state BFT liability. Because the Credit carryovers were amended, the Department was obligated to adjust the Credit carryovers when it disallowed the deduction.

Mathematical Errors

During the course of considering the Bank's appeal, a number of minor transposition errors were discovered on the amended returns. The Bank has provided documentation to verify the correct amounts.

CONCLUSION

In accordance with this determination, the adjustment to increase equity capital for the 2014 tax year by including noncontrolling (minority) interests in consolidated subsidiaries is reversed. In addition, the Department will allow a deduction for both retained earnings and surplus of the Bank's subsidiaries to the extent included in gross capital. Finally, the Credit carryovers must be corrected to show the amounts that should have been claimed for the 2012 through 2014 tax years. The enclosed schedules display the adjustments (including mathematical errors) to be made as a result of this determination. The overpayments of state BFT, including applicable interest, will be refunded shortly. The Department will notify the affected localities and refunds of the local portion of the BFT will be issued by those localities.

The *Code of Virginia* sections, regulations, and public documents cited are available on-line at www.tax.virginia.gov in the Laws, Rules & Decisions section of the Department's web site. If you have any questions regarding this determination, you may contact David T. Mason in the Department's Office of Tax Policy, Appeals and Rulings, at (804) 371-6041.

Sincerely,

Craig M. Burns
Tax Commissioner

Enclosure

AR/1289o