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December 31, 2018

Mr. Todd Renner
Executive Director, Office of Tax Policy and Regulation
Kentucky Department of Revenue

Via email

Re: Financial Services Impact of Proposed 103 KAR 16:270 (Apportionment; receipts factor)

Dear Mr. Renner,

On behalf of the Council On State Taxation (COST), I am writing to urge the Department of Revenue to consider amendments to proposed 103 KAR 16:270 (Apportionment; receipts factor) to ensure that the income of financial services companies not otherwise taxed under the Bank Franchise Tax is properly apportioned to the Commonwealth. These comments are limited to the issue described below and are not intended to address other issues pertaining to the receipts factor or the Department’s proposal.

Kentucky levies its Bank Franchise Tax in lieu of the Corporation Income Tax on each “financial institution,” as defined in KRS 136.500(10). This definition of “financial institution” is narrow, however, leaving many financial services companies subject to the Corporation Income Tax and therefore to apportionment under the Department’s proposed regulation. For example, these proposed rules would apply to bank holding companies and their subsidiaries and securities broker/dealers.

The general apportionment provisions proposed in 103 KAR 16:270 are inappropriate to apply to financial services companies. Under KRS 141.120(1)(e), “receipts” means all apportionable gross receipts received “from transactions and activity in the regular course of the taxpayer’s trade or business,” but excludes *all* receipts from hedging transactions and from the maturity, redemption, sale, exchange, loan or other disposition of cash or securities. While such transactions may not be part of the “regular course” of some businesses, this is certainly not the case for most financial services companies. A blanket exclusion of such receipts, when applied to financial services companies, is likely distortive and is contrary to the intent of the statute to exclude receipts that occur outside the regular course of a taxpayer’s trade or business.

The Multistate Tax Commission (MTC) recognized this problem when earlier this year it adopted a model regulation to recommend special apportionment provisions

for bank holding companies and their subsidiaries.¹ This model regulation applies the MTC's financial institutions apportionment provisions,² which justifiably includes interest from lending and net gains from investment and trading activity.

For securities broker/dealers, the MTC in its reports on Section 18 hearings from 1997 - 2001³ specifically indicated that receipts from securities dealer activities principally in the ordinary course of business were to be treated as any other sales of property inventory.

COST urges the Department to consider amendments to its proposed 103 KAR 16:270 regulation to include receipts from financial services companies' regular trade or business in the receipts factor. These should include, but is not limited to, bank holding companies and their subsidiaries and securities broker/dealers. For bank holding companies and their subsidiaries, we urge the Department to amend the proposed regulation to include the language in the MTC's model Reg. IV.18.(k), Receipts Factor – Bank Holding Companies and Subsidiaries.

Sincerely,



Ferdinand Hogroian

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director

¹ See Reg. IV.18.(k), adopted July 25, 2018, available at [http://www.mtc.gov/getattachment/Uniformity/Adopted-Uniformity-Recommendations/2018-Commission-Meeting-Proposed-Sec-18\(k\)-\(1\).pdf.aspx?lang=en-US](http://www.mtc.gov/getattachment/Uniformity/Adopted-Uniformity-Recommendations/2018-Commission-Meeting-Proposed-Sec-18(k)-(1).pdf.aspx?lang=en-US).

² Available at <http://www.mtc.gov/getattachment/Uniformity/Adopted-Uniformity-Recommendations/Financial-Institutions-Apportionment-Rule-Amended-2015.pdf.aspx>.

³ See

http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/Adopted_Recommendations/By_Category/Net%20Gains%20from%20Certain%20Intangibles%20Sales%20Factor%203224_001.pdf