

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition :  
of  
Franklin Savings Bank of New York : AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or a Revision :  
of a Determination or a Refund of Franchise Tax  
under Article 32 of the Tax Law for the Years 1974, :  
1975 & 1976.

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State of New York  
County of Albany

David Parchuck, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 1st day of April, 1983, he served the within notice of Decision by certified mail upon Franklin Savings Bank of New York, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Franklin Savings Bank of New York  
380 Madison Ave.  
New York, NY 10017

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this  
1st day of April, 1983.

David Parchuck

Annunzio A. DiStefano

AUTHORIZED TO ADMINISTER  
OATHS PURSUANT TO TAX LAW  
SECTION 174

STATE OF NEW YORK

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of :  
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State of New York  
County of Albany

David Parchuck, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 1st day of April, 1983, he served the within notice of Decision by certified mail upon Albert J. Cardinali the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Albert J. Cardinali  
Thacher, Proffitt & Wood  
40 Wall St.  
New York, NY 10005

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this  
1st day of April, 1983.

David Parchuck

Conrad R. Van Buren  
AUTHORIZED TO ADMINISTER  
OATHS PURSUANT TO TAX LAW  
SECTION 174

STATE OF NEW YORK  
STATE TAX COMMISSION  
ALBANY, NEW YORK 12227

April 1, 1983

Franklin Savings Bank of New York  
380 Madison Ave.  
New York, NY 10017

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1455 of the Tax Law, any proceeding in court to review an adverse decision by the State Tax Commission can only be instituted under Article 78 of the Civil Practice Laws and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance  
Law Bureau - Litigation Unit  
Albany, New York 12227  
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative  
Albert J. Cardinali  
Thacher, Proffitt & Wood  
40 Wall St.  
New York, NY 10005  
Taxing Bureau's Representative

STATE OF NEW YORK

STATE TAX COMMISSION

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In the Matter of the Petition  
of  
FRANKLIN SAVINGS BANK OF NEW YORK  
for Redetermination of a Deficiency or for  
Refund of Franchise Tax on Banking Corporations  
under Article 32 of the Tax Law for the Years  
1974, 1975 and 1976.

DECISION

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Petitioner, Franklin Savings Bank of New York (now, American Savings Bank), 380 Madison Avenue, New York, New York 10017, filed a petition for redetermination of a deficiency or for refund of franchise tax on banking corporations under Article 32 of the Tax Law for the years 1974, 1975 and 1976 (File No. 22959).

A formal hearing was held before Doris Steinhardt, Hearing Officer, at the offices of the State Tax Commission, Two World Trade Center, New York, New York, on May 21, 1981 at 9:15 A.M. Petitioner appeared by Thacher, Proffitt & Wood, Esqs. (Douglas J. McClintock, Esq. and Albert Cardinali, Esq., of counsel). The Audit Division appeared by Ralph J. Vecchio, Esq. (Samuel Freund, Esq., of counsel).

#### ISSUES

I. Whether the ceiling placed upon taxable interest or dividends for purposes of the alternative minimum tax under section 1455(b)(2) of the Tax Law, i.e., "the interest or dividend which would have been credited if it had been computed and credited at the rate of three and one-half percent per annum," requires the interest to be computed as simple annual interest or in accordance with petitioner's compounding and crediting practices.

II. Whether petitioner's use of the "actual" interest rate in the conversion factor in its computation of the alternative minimum tax under section 1455(b)(2) of the Tax Law was proper.

FINDINGS OF FACT

1. Petitioner, Franklin Savings Bank of New York (the "Bank"), was the surviving corporation of a merger and is currently known as American Savings Bank. Effective midnight of April 24, 1981, American Savings Bank and Empire Savings Bank merged into Franklin Savings Bank of New York under the name American Savings Bank.

2. On its returns for the years at issue, the Bank computed its tax liability under the alternative minimum method of subdivision (b) of section 1455 of Article 32.

The Bank first determined its "actual" rate of interest for the year by dividing (a) the actual amount of dividends and interest credited during the year, less penalties forfeited upon premature withdrawal of time deposits,<sup>1</sup> by (b) the Bank's average daily deposit liability over 365 days. In determining the average daily deposit liability, all dividends and interest credits during the year were excluded.

<u>YEAR</u>	<u>ACTUALLY CREDITED (ACCOUNTS OVER 3.5%)</u>	<u>AVERAGE DAILY DEPOSIT LIABILITY</u>	<u>"ACTUAL" RATE OF INTEREST</u>
1974	\$60,563,528.76	\$1,032,018,401.97	5.8684%
1975	63,653,475.51	1,055,178,527.25	6.0324%
1976	70,211,463.51	1,140,835,840.32	6.1544%

Petitioner then computed the amount of dividends and interest which would have been credited at the statutory 3.5 percent, for those accounts which

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<sup>1</sup> This Commission heretofore determined, in the Matter of The Manhattan Savings Bank (June 26, 1981), that the netting of penalties against interest has no statutory support and is impermissible.

earned more than 3.5 percent, by multiplying the amounts actually credited to such accounts by a fraction, the numerator of which was 3.5 percent and the denominator of which was the Bank's "actual" rate of interest for the particular year.

<u>YEAR</u>	<u>ACTUALLY CREDITED (ACCOUNTS OVER 3.5%)</u>	<u>FACTOR</u>	<u>AMOUNTS WHICH WOULD HAVE BEEN CREDITED AT 3.5%</u>
1974	\$60,563,528.76	3.5/5.8684	\$36,120,936.44
1975	63,653,475.51	3.5/6.0324	36,931,746.49
1976	70,211,463.51	3.5/6.1544	39,931,786.91

Finally, petitioner calculated the tax base by adding (a) dividends and interest which would have been credited at 3.5 percent and (b) dividends and interest actually credited for accounts which earned less than 3.5 percent.

<u>YEAR</u>	<u>AMOUNTS WHICH WOULD HAVE BEEN CREDITED AT 3.5%</u>	<u>AMOUNTS ACTUALLY CREDITED (ACCOUNTS UNDER 3.5%)</u>	<u>TAX BASE</u>
1974	\$36,120,936.44	\$ 7,161.85	\$36,128,098.29
1975	36,931,746.49	11,335.03	36,943,081.52
1976	39,931,786.91	12,786.82	39,944,573.73

3. On June 9, 1978, the Audit Division issued to petitioner three notices of deficiency asserting additional franchise taxes due under Article 32, plus interest, scheduled as follows:

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
1974	\$21,988.35	\$ 5,818.99	\$ 27,807.34
1975	33,599.88	6,035.88	39,635.76
1976	<u>38,916.35</u>	<u>3,683.04</u>	<u>42,599.39</u>
	\$94,504.58	\$16,726.33	\$111,230.91

In order to determine dividends and interest which would have been credited at the statutory 3.5 percent rate, for those accounts which earned more than 3.5 percent, the Audit Division multiplied the amounts actually credited to such accounts by a fraction, the numerator of which was 3.5 percent

and the denominator of which was the "stated" rate of interest (e.g., 5.25 percent). The computation was carried out for each class of account and all results added, e.g., (\$1,000 credited to 5.25% accounts x 3.5/5.25) + (\$1,500 credited to 6.00% accounts x 3.5/6.00), etc.

The Audit Division then calculated the tax base by adding (a) dividends and interest which would have been credited at 3.5 percent and (b) dividends and interest actually credited for accounts which earned less than 3.5 percent.

4. The Bank paid dividends and interest at a compounded rate for all accounts except the 2, 9 and 11 percent accounts, on which simple interest was paid. Petitioner compounded interest daily and credited interest quarterly on a 365/360 basis. (The stated rate is divided by 360 and interest compounded at such rate each calendar day.)

5. Banks are required to publish the "advertised effective" rate of interest, in addition to the "stated" rate. The advertised effective rate is computed for each account class and is based upon the assumptions that a sum is deposited on the first day of the year and remains on deposit throughout the year, and that no withdrawals occur. A 5.25 percent account thus has an advertised effective rate of 5.47 percent.

6. The "actual" rate of interest is computed by the Bank as previously described: by dividing the amount of dividends and interest actually credited during the year (less penalties) by the average daily deposit liability (excluding dividends and interest). Dividends and interest are excluded from daily deposit liability, according to petitioner, in order to arrive at the "pure" deposit liability and "true cost" of interest to the Bank.

7. Under the Audit Division's method, the computation must be done for each account class; aggregation is not possible. Petitioner maintains (among other things) that due to the large number of rates and the frequency with which rates change, the Audit Division's method is significantly more complex.

8. An element which distinguishes the Audit Division's computation method from the Bank's method is compounding, and as such, is the crux of this proceeding.

The Bank excluded dividends and interest from average daily deposit liability in calculating "actual" rate, thereby eliminating the compounding element.

The Audit Division's method, on the other hand, takes into consideration the compounding element through the use of the "stated" rate. Under such method, the tax bases for two accounts which have different compounding frequencies, but are identical in all other respects, will not be equal; nor will the tax bases for two accounts with different stated interest rates (over 3.5 percent), which are identical in all other respects, be equal.

#### CONCLUSIONS OF LAW

A. That section 1451 of the Tax Law imposes upon every banking corporation exercising its franchise or doing business in this state a tax to be computed under section 1455. Subdivision (b) of section 1455 provides the method for computation of the alternative minimum tax; paragraph (2) of said subdivision, as in force during the years at issue, provided:

"For a savings bank and savings and loan association, two percent of the interest or dividends credited by it to depositors or shareholders during the taxable year, provided that, in determining such amount, each interest or dividend credit to a depositor or shareholder shall be deemed to be the interest or dividend actually credited or the interest or dividend which would have been credited if it had been computed and credited at the rate of three and one-half percent per annum, whichever is less." (Emphasis added.)



B. That the alternative minimum tax was adopted in 1945 (L. 1945, ch. 764) as subdivision (3) of section 219-q of the Tax Law.

"[A] savings bank shall be subject to a minimum tax of not less than ten dollars and not less than an amount equal to two per centum of the amount of interest credited by it to depositors during the calendar year preceding that in which such tax becomes due..."

In 1951 savings banks became subject to Federal income tax, and because earnings were rising and interest paid to depositors was (and is) deductible under the Internal Revenue Code, savings banks began to pay higher interest rates to their depositors. In 1953 section 219-q(3) was amended to place a statutory ceiling on the alternative minimum tax (L. 1953, ch. 282).

"[A] savings bank and savings and loan association shall be subject to a minimum tax of not less than ten dollars and not less than an amount equal to two per centum of the amount of interest or dividends credited by it to depositors or shareholders during the calendar year preceding that in which such tax becomes due, provided that, in determining such amount, each interest or dividend credit to a depositor or shareholder shall be deemed to be the interest or dividend actually credited or the interest or dividend which would have been credited if it had been computed and credited at the rate of two per centum per annum, whichever is less..."

In 1968 the ceiling was raised to three percent per annum (L. 1968, ch. 247); and in 1971, to 3.25 percent and again to 3.5 percent per annum (L. 1971, ch. 70 and 71).

C. That the 1953 amendment to section 219-q(3) imposing a ceiling on the tax base for purposes of the alternative minimum tax was drafted by the Department of Taxation and Finance and introduced in the legislature at the Department's request. An examination of the bill jacket contents reveals that the ceiling was intended to equal the first two percent of interest actually credited to depositors' accounts.

"[B]y the Revenue Act of 1951, [Congress] subjected savings and loan associations, which had theretofore been exempt, to federal income taxation for the first time. Savings banks were similarly made subject to federal income taxation by the same 1951 enactment.

Thereunder, amounts credited to depositors' accounts are deductible and this has led to increases in the dividend rates from two percent to two and one-half percent or higher. The amendment to subdivision 3 of section 219-q modifies the alternative minimum tax based upon such dividend credits to limit the application of the tax to the first two percent of interest credited to depositors' accounts -- the base upon which this minimum tax has been computed for a number of years." Letter to Hon. Thomas E. Dewey from Commissioner Spencer E. Bates, March 23, 1953.

"The present tax on savings banks is  $4\frac{1}{2}$  per cent of net income, after dividends, with a minimum tax of 2 per cent on dividends declared. The bill would make the following change [ ]:...Adjust the minimum tax to 2 per cent on dividends declared up to a rate of 2 per cent." Legislative Memorandum.

"Under existing law, savings banks are taxed 2 per cent on the total amount of dividends paid depositors. The proposed legislation, while maintaining the 2 per cent tax rate, would confine its application to the first 2 per cent of total dividends, exempting from taxation all payments to depositors in excess of that amount. In this connection it is interesting to note that the interest rates of most savings banks and savings and loan associations even at the present time are higher than the proposed 2 per cent tax ceiling." Memorandum of New York State Bankers Association, March 13, 1953.

See also Governor's Memorandum, 1953 New York State Legislative Annual 341.

D. That in the computation of the statutory ceiling, petitioner's compounding and crediting practices must be taken into consideration. Interest, left on deposit after crediting, enters into the tax base. Petitioner's exclusion of interest and dividends credited during the year from the average daily balance was thus improper. The tax base for the alternative minimum tax will indeed increase as the frequency of crediting increases or as the rate of interest rises, as noted in Finding of Fact "8", since the amount of interest actually credited to depositors' accounts likewise increases under either circumstance.

E. That while the petitioner's use of the actual rate of interest in its conversion factor (described in Finding of Fact "2") produces a more refined tax base than the Audit Division's use of the stated rate in such factor (described in Finding of Fact "3"), the petitioner's conversion factor does not reflect petitioner's compounding and crediting practices. Petitioner also

erroneously netted penalties forfeited upon premature withdrawal of time deposits in computing its conversion factor. Accordingly, the Audit Division is hereby directed to recompute petitioner's alternative minimum tax liability by recomputing the "actual" interest rate in the conversion factor by taking cognizance of petitioner's compounding and crediting practices<sup>2</sup> and by including all penalties forfeited upon premature withdrawal of time deposits as follows:

1. Divide total interest and dividends credited for the taxable year (including penalties forfeited upon premature withdrawal of time deposits) by the number of days in such year.

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<sup>2</sup> On September 12, 1978, the Taxpayer Services Division published a memorandum (TSB-M-78(21)C), setting forth the method whereby the alternative minimum tax was to be computed thenceforth. If the simple annual rate of interest is greater than 3.5 percent per year, the alternative minimum tax is computed as follows:

"1. Accounts are grouped as to type, that is, all accounts which have the same simple annual rate of interest (e.g. 5½% per annum), the same dividend factor (360/360, 365/365, 365/360), the same method of compounding (e.g. daily), the same basis of compounding (e.g. day of deposit to day of withdrawal), and the same frequency of crediting interest to the account (e.g. monthly) are grouped together.

"2. Ascertain the amount of interest which would have been credited to that type of account for each period for which interest is credited as if the simple annual rate of interest had been 3½% per year. That is, the same method that is used in determining what amount of interest is to be credited to an account for the simple annual rate of interest shall be used when applying the 3½% rate of interest. For purposes of computing the amount of interest which would have been credited in the case of daily compounding, it is permissible to use the average daily balance for the period for which interest is credited rather than the actual daily balance for each day in such period. For example, it is permissible to use the daily balance for the period January 1 to March 31 if interest is credited to that type of account quarterly."

The memorandum is effective for years subsequent to those herein involved. Computation of petitioner's tax pursuant to this memorandum is not possible since the record contains insufficient evidence of the transactional history of each type of account.

2. Multiply the result determined in step 1 by the number of days in the first quarter. Also make this computation for the second and third quarters. The result is the interest and dividends credited at the end of each quarter (hereinafter "quarterly interest").
3. Multiply the quarterly interest for the first quarter (as computed in step 2) by 91 (the number of days in the second quarter) and add to the result the total daily deposit liability as computed by the taxpayer for the second quarter.
4. Multiply the sum of the first and second quarterly interest (as computed in step 2) by 92 (the number of days in the third quarter) and add to the result the total daily deposit liability as computed by the taxpayer for the third quarter.
5. Multiply the sum of the first, second and third quarterly interest (as computed in step 2) by 92 (the number of days in the fourth quarter) and add to the result the total daily deposit liability as computed by the taxpayer for the fourth quarter.
6. Add to the amounts determined in steps 3, 4 and 5, the total daily deposit liability as computed by the taxpayer for the first quarter.
7. Divide the sum computed in step 6 by the number of days in the taxable year. The result is the petitioner's average daily deposit liability for the taxable year (taking cognizance of petitioner's compounding and crediting practices and penalties forfeited upon premature withdrawal of time deposits).
8. The "actual" rate of interest in the conversion factor is computed by dividing (a) the actual amount of dividends and interest credited during the taxable year (including penalties forfeited upon premature withdrawal of time deposits), by (b) the amount determined in step 7 (the petitioner's average daily deposit liability for the taxable year).

F. That the petition of Franklin Savings Bank of New York is granted to the extent indicated in Conclusion of Law "E"; that the notices of deficiency

issued June 9, 1978 are to be modified accordingly; and that except as so modified, the deficiencies are in all other respects sustained.


DATED: Albany, New York

APR 01 1983

STATE TAX COMMISSION

  
ACTING PRESIDENT

  
COMMISSIONER

  
COMMISSIONER