



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
CROCKER NATIONAL CORPORATION } No. 82.X-1785-23

Appearances:

For Appellants: Franklin C. Latcham
James Kleier
Attorneys at Law

For Respondent: Karl F. Munz
Counsel

O P I N I O N

This appeal is made pursuant to section 25666^{1/} of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Crocker National Corporation against proposed assessments of additional franchise tax in the amounts of \$217,898 and \$114,645 for the income years 1975 and 1976, respectively.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income years in issue.

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This appeal involves two issues. The first is whether, for property and sales factor purposes, respondent properly assigned to California all of **Crocker National Bank's** investment in, and rental receipts from, tangible personal property leased to others and physically located in states in which the bank was shielded from state taxation by virtue of Public Law No, 93-100. The second issue is whether, again for property and sales factor purposes, respondent correctly assigned to California the loans (and interest **income therefrom**) that federal banking regulatory authorities attributed to **Crocker National Bank's Cayman Islands** branch office.

The first issue concerns only the 1976 income year and involves tangible personal property which appellant's unitary subsidiary, **Crocker National Bank** (hereinafter referred to as **Crocker**), owned and leased to others. During the year in question, all of this property was physically located in states other than California, and **Crocker** was insulated from state taxation in every state except California, because of Public Law No. 93-100.^{2/} For property and sales factor purposes, respondent attributed to California all of **Crocker's** investment in, and rental receipts from, this property. Originally, this was done by respondent's audit staff pursuant to a published "guideline" respondent had developed to govern the apportionment of income earned by banks and financial corporations. Subsequently, respondent adopted a regulation (Cal. Admin. Code, tit, 18, reg. 25137-4) to replace the guideline, and, since respondent did not make the regulation prospective only in application, it is fully retroactive to all open years. (See Rev. & Tax. Code, § 26422; Appeal of BanCal Tri-State Corporation, Cal. St.. Bd. of Equal., Mar. 4, 1986.)

2/ The pertinent part of Public Law No. 93-100 provided that, for any taxable year beginning on or after August 16, 1973, and before September 12, 1976, no state could levy any kind of "doing business" tax, including a tax measured by income, on an insured depository like **Crocker**, unless the principal office of the depository was located in that state. Thus, for **Crocker's** income year 1976, which began January 1, 1976, this Public Law prohibited any state but California (where **Crocker's** principal office is located) from taxing **Crocker's** in-state business activities.

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The provisions of the regulation applicable to leases of tangible personal property for property factor purposes state as follows:

'Where the taxpayer leases tangible personal property to another the entire cost of such property shall be attributed to the state of the taxpayer's commercial domicile unless the taxpayer establishes, or the Franchise Tax Board is able to establish the location of such property in another state or states for the entire year and the taxpayer is taxable in the state or states where the property is located.

(Cal., Admin. Code, tit. 18, reg. 25137-4, subd. (c)(1)(B)(iii).)

With respect to the sales factor, the regulation provides:

Receipts from the lease or rental of tangible personal property shall be attributed to the state of the taxpayer's commercial domicile unless the taxpayer or the Franchise Tax Board is able to establish the location of such property in another state or states for the entire year and the taxpayer is taxable in the state or states where the property is located.

(Cal. Admin. Code, tit. 18, reg. 25137-4, subd. (c)(2)(A).)

Respondent contends that the cost of the leased property and the receipts from the Leases were properly assigned to California, the state of Crocker's commercial domicile, because Crocker was not taxable in any other state, by virtue of Public Law No, 93-100.

Section 25122 provides that a taxpayer is taxable in another state if:

(a) in that state it is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (b) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

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Since no contention is made that Crocker was actually subject to any tax in the states in which the Leased property was located, the only question is whether those states had jurisdiction to impose a net income tax on Crocker. According to respondent's regulations, this second test of taxability "applies if the taxpayer's business activity is sufficient to give the state jurisdiction to impose a net income tax by reason of such business activity under the Constitution and statutes of the United States." (Cal. Admin. Code, tit. 18, reg. 25122, subd. (c) (art. 2.5).) In this case, Public Law No. 93-100 deprived every state but California of jurisdiction to levy an income tax on Crocker's activities. It is clear, therefore, that Crocker was not taxable in those states within the meaning of the applicable statutes and regulations. Consequently, respondent acted properly and in accordance with regulation 25137-4 in assigning the values arising from Crocker's leases to California,

The second issue concerns the Cayman Islands branch which Crocker established in 1973 to serve its international customers. Crocker had no employees in the Cayman Islands to staff this branch, and it apparently did not establish an independent office location there. Rather, it retained the Bank of Montreal Trust Corporation to act as its agent in the Cayman Islands, to maintain records and accounts of the Cayman branch, and to file the financial reports required by the laws of the Cayman Islands. Crocker made loans to its foreign customers through this branch which were recognized by both federal banking regulatory authorities and the Cayman Islands' authorities as being made from and as assets of the Cayman Islands branch. For property and sales factor purposes, respondent assigned these loans and the interest therefrom to California, where all of the activities performed by Crocker's own employees with respect to the loans actually took place-

Regulation 25137-4 provides, for property -factor purposes, that loans are to be assigned- to a particular state in the following manner:

Assets in the nature of loans (including federal funds sold and banker's acceptances) and installment obligations shall be attributed to this state if the office of the bank or financial corporation at which the customer applied for the loan is located in this state except in cases where the loan is recognized

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by appropriate banking regulatory authority as being made from and as an asset of an office located in another state, in which case it shall be attributed to the state where that office is located. For purposes of this subclause, the word "applied" means initial inquiry (including customer assistance in preparing the loan application) or submission of a completed loan application, whichever occurs first in time. (Emphasis added.)

(Cal. Admin. Code, tit. 18, reg. 25137-4, subd. (c) (1) (B) (ii) (I).)

The regulation assigns loan interest in an identical fashion for sales factor purposes:

Interest and other receipts from assets in the nature of loans (including federal funds sold and banker's acceptances) and installment obligations shall be attributed to this state if the office at which the customer applied for the loan is located in this state. except in cases where the loan is recognized by appropriate banking regulatory authority as being made from and as an asset of an office located in another state, in which case it shall be attributed to the state where that office is located. For purposes of this clause, the word "applied" means initial inquiry (including customer assistance in preparing the loan application or submission of a completed loan application) whichever occurs first in time. (Emphasis added.)

(Cal. Admin. Code, tit. 18, reg. 25137-4, subd. (c) (2) (B) (i).)

On its face, the regulation appears to require that the loans and interest be assigned to the Cayman Island's, since it is undisputed that all banking regulatory authorities considered the loans as made from and as assets of the Cayman Islands branch. Respondent contends, however, that this branch was not really an "office" and wasn't "located" in the Cayman Islands within the meaning of the regulation. The basis for this position is respondent's view that the Cayman Islands branch was a mere "shell" or "paper" entity lacking in substance.

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We believe that the regulation does, in fact, require that the loans and loan interest be attributed to the Cayman Islands. The clear thrust of the plain language of the regulation is to assign loans to the office where they are "booked" as assets, when that location differs from the place where the customer applied for the loan. Here, federal banking regulatory authorities recognized the loans as "booked" at Crocker's Cayman Islands branch. If that branch constitutes an office for "booking" purposes, no substantial reason appears why it shouldn't also constitute an "office" for purposes of regulation 25137-4. The regulation certainly does not state that an "office" must possess certain specific characteristics. Had respondent so intended, it could easily have included a definition of "office" in the regulation; indeed, it may still do so, if it chooses to amend the regulation. In our view, however, Crocker's Cayman Islands branch certainly had sufficient substance to constitute an office for present purposes, it was licensed by the Cayman Islands government, which imposed an annual license fee on Crocker, and it was specifically authorized and recognized by the Federal Reserve Board as a foreign branch banking facility actually located in the Cayman Islands.^{3/} Under these circumstances, we do not believe that this branch can fairly be classified as a mere "shell" or sham facility.

For the above reasons, respondent's action will be modified to reflect our determination that the loans and loan interest were properly attributable to the Cayman Islands for factor purposes.

^{3/} The Federal Reserve Board in fact required Crocker to advise it when the branch opened for business and where its "exact location" was. It further required notification of any future changes in location of the branch, and it also specifically authorized Crocker to contract with another party to provide "quarters, staff, and book-keeping" for the branch.

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O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the **Revenue** and Taxation **Code**, that the action of the Franchise Tax Board on the protest of **Crocker** National Corporation against proposed assessments of additional franchise tax in the amounts of \$217,898 and \$114,645 for the income years 1975 and 1976, be and the **same** is hereby modified to assign the **Cayman** Islands branch loans and loan interest to the **Cayman** Islands for purposes of the property and sales factors. In all other respects, the action of the Franchise Tax Board is **sustained**.

Done at Sacramento, California, this 19th day of November, 1986, by the State Board of Equalization, with Board Members Mr. Nevins, Mr. Collis, Mr. Bennett, Mr. Dronenburg and Mr. Harvey present.

_____	, Chairman
Conway H. Collis	, Member
William M. Bennett	, Member
Ernest J. Dronenburg, Jr.	, Member
Walter Harvey*	, Member

*For Kenneth Cory, per Government Code section 7.9