Bank Tax - TRAC Testimony Give by Lloyd Hendricks, President and CEO of South Carolina Bankers Association

Thank you for the opportunity to appear before the commission today and we thank you for your service to assess the effectiveness of the state's current tax structure.

I am Lloyd Hendricks, President and CEO of the South Carolina Bankers Association.

Also with me today is Neil Rashley, Senior Vice President & Counsel, Amber Setzler, Director of Government Relations and Chris Lindsey, our contract lobbyist.

Introduction

- The South Carolina Bankers Association represents banks and thrifts of all sizes and charters and is the voice in the South Carolina Legislature for our 107 banks and savings and loans doing business in South Carolina's communities.

- Their deposits total more than $70 billion.

- 46 institutions have a federal charter- Regulators are OCC, OTS, Federal Reserve and the FDIC

- 61 institutions have a state charter- Regulators are State Board of Financial Institutions, Federal Reserve, State Banking Examiners and the FDIC

- 1,463 branches and offices

- 56 holding companies in SC

- 21 of the 107 finance institutions are savings and loans.

- We merged the CFISC into our association 13 years ago.

- Our banks in SC employ 12,000 people according to the FDIC in September 2009.

Bank and Thrift Tax

- In FY 2009 banks and savings and loans paid a combined total of $12 million in state income taxes to the State of South Carolina. However, this figure is down due to the overall slowdown in the economy.

- In 2008, the combined income tax revenue for banks and savings and loans was over $22 million and in 2007 the total topped $28 million. Income taxes in 2006 and 2005 exceeded $30 million in each of these years. Total for the past 5 years it exceeded $125 million.

- Banks paid more than $56 million in federal taxes in 2008.

- In South Carolina, banks pay an income tax that is not calculated in the same manner as for a C corporation. The bank tax is a franchise tax. Banks are taxed pursuant to Chapter 11 of Title 12.

- S.C. Code § 12-11-20 provides that the entire net income of a bank in South Carolina is to be taxed at 4 ½% rate annually.

- This income is "book income" not "taxable income" which is what C Corps are taxed on. As a result all income and expenses are included in the tax calculation for a bank. And the entire net income is calculated without regard to the majority of the book/tax differences considered for federal income tax purposes, including the NOL carry forward.

- Like banks, savings and loans (thrifts) are taxed pursuant to a separate statute - Chapter 13 of Title 12.

- Thrifts' tax is 6% of net income but, unlike banks, their tax is an income tax.

- §12-13-20 - Net income does not include "income from municipal, state, or federal bonds or securities exempted by law from the tax, including interest earned on deposits at the Federal Home Loan Bank of Atlanta, or its successors, for those savings and loan associations which meet the qualified thrift lender test set forth in the Financial Institutions Reform, Recovery and Enforcement Act of 1989." (FIRREA) – This act was intended to shore up deposit insurance funds and improve the safety and soundness of financial institutions. (Established FDIC- SAIF)

History of Bank Tax Statutes

- These statutes were added by the General Assembly in 1937 in order to insure a level of stability for banks and have only been amended once to modernize the term "deed recording fee."
- I would like to refer to the proceedings of the 1937 SCBA Annual Convention. It is interesting to note that the principle speaker at the 1937 SCBA Annual Convention was none other than the Honorable Burnet R. Maybank.

- Before 1937, there was an *ad valorem* tax on bank shares. This type of taxation placed a great strain on banks so the South Carolina Tax Commission recommended to the General Assembly that banks be taxed on their income (profitability). This was a conscious decision made by the Ways and Means Committee, the General Assembly and the State Tax Commission to balance taxation of national and state banks in an effort to keep our banks well capitalized.

- The General Assembly and the Tax Commission also recommended that this new income tax be in lieu of all other taxes except real property taxes. Other state had also changed to this type of bank taxation and found it to be successful.

- Capital is king in our business and liquidity is queen, and this was recognized in 1937 following the depression as well as it is today. It is a huge factor following this recession. $1 in capital supports up to $10 of new loans (statement made by Dr. Jim Chessen Chief Economist for ABA, before the committee on finance US Senate on May 4, 2010). The bank tax has direct and severe consequences for large institutions, and it has a broader impact on the smaller banks as well.

- Public policy makers must strike a careful balance between keeping lenders well- capitalized and the desire for revenue.

Other Taxes

- Banks and thrifts pay real property taxes, use taxes and deed recording fees.

- However, S.C. Code § 12-11-30 states that banks pay the income tax in § 12-11-20 in lieu of all other taxes except for real property taxes, use tax and deed recording fees.

- Thrifts have an identical provision in § 12-13-40.

- There is one sales tax exemption involving banking and it is found in S.C. Code § 12-36-2120(11)(d). The exemption is for transactions involving automated teller machines and was added in 1986 as ATMs became prevalent as means for electronic banking transactions – especially for consumers.

Banks Pay Their Fair Share and Community Contributions

- Banks do pay their fair share because some of it is because of who we are. For example, CRA and FDIC premiums. Other businesses have nothing like this. And the increased assessment of FDIC premiums on some of our community banks this past year have resulted in increased expenses exceeding 500%.

- South Carolina’s banks contribute to the community in many other ways. In particular, banks are subject to the federal government’s Community Reinvestment Act that requires financial institutions to meet the credit needs of their communities, including the low and moderate income sections of the local community. We have to make reports concerning our investment in the areas where we do business, and this is made public as to whether we receive a satisfactory rating.

- Total CRA dollars in 2008 (latest figures from FFIEC) - $3.6 billion

- Despite financial and regulatory pressures, SC banks have continued their tradition of providing financial and human resources for economic and community development organizations. A 2010 community investment survey that the SC bankers recently conducted showed that SC banks made more than $200 million in Community Development Loans in 2009.

- The total amount of bonds purchased was $62 million.

- Banks also had a charitable impact with more than $9 million in giving and 190,000 hours of volunteer work – benefiting more than 2000 charities.

- Our young bankers division has received the national award from ABA 8 out of the past 10 years for its efforts in financial education and financial literacy in our schools, reaching 60,000+ students each year.

- Traditional SC bankers continue their work leading charitable fundraisers, coordinating economic development initiatives, lending to local businesses, facilitating the dream of home ownership, purchasing local government bonds, and leading financial literacy efforts at local schools. This work happens not because of any state or federal mandate, but because a bank's success is tied directly to the creation of a healthy thriving community.

Points Concerning Banks Not Paying Personal Property Tax

- Although it is true that banks and thrifts do not pay personal property taxes, they do pay significant real property taxes, and state and federal income taxes. SC has always been a branching state, and due to significant branching over the years, bank's exposure to real property taxes is considerable.

- Public policy makers understand that different industries need to be taxed differently based on their services and goods. This is extremely true for the lending industry.

- Banks and other lenders are the lifeblood of the consumer and business sector. Banks are good for the local communities throughout SC with over 1400 locations to serve the public and taxation of the banks must be taken seriously. Over-taxation will result in a lack of capitalization for banks and would affect lending.

- Banks are the most heavily taxed and regulated of all lenders. For certain public policy reasons, credit unions and farm credit do not pay taxes. Taxes paid from 2003-2007 for SC Banks was $1,209,503,000 and for SC Credit Unions it was $0 (from approximately 82 state-chartered credit unions). Includes federal, state, and local taxes reported on the banks' call report to FDIC.

- Just as there are legitimate reasons to exempt other lenders from overall taxation, the personal property exemption for banks has a legitimate purpose. Banks have been technology heavy over the years with major investments in computers and programs. This is for the benefit of our customers and users in SC and is found in all 1400 branches and in our operation centers. You would have to look at furniture, fixtures, vaults ATMs and ATM equipment, teller lines (booths) and special computer equipment, all of which is unique to our business, if you were to impose another tax on us.

- The exemption was put in statute in order to balance the tax burden on banks and to provide for adequate capitalization and thus lending. This exemption was debated and recommended by the Tax Commission and the General Assembly in 1937 as part of the overall changes to bank taxation. It was not "slipped in" and has remained the same for more than 70 years.

- **Conclusion:** The banking industry has been severely affected by the challenging economic environment and recently passed congressional regulatory reform that eliminates $129 billion in capital from the Trust Preferred Securities in the US Banking system.

- Additionally, bank regulators have already reacted in significant and severe ways to rein in certain practices and increase disclosures. In the last year and a half, the Federal Reserve alone has issued 31 new or revised regulations. Each carries with it a significant allocation of bank time and money and builds upon volumes of existing regulation. This is putting a strain on community banks and is becoming a nearly insurmountable burden.

- We also have pressure on us to lend and this reduces our capital. The last thing we need in this environment is another regulation or tax put on our industry.

- Public policy leaders across the nation and in the states have long recognized that taxation of lending institutions is different. And, this is for obvious reasons – lenders are the lifeblood of the business community and vital to the local economy. For all these reasons Mr. Chairman and members of the commission, we ask that you recommend no changes to our present statutes and that you not burden the very institutions who have been responsibly serving their communities.

- Thank you again for the invitation to be with you today and for your service on this commission.