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Mr. Robert D. Plattner
Deputy Commissioner
Office of Tax Policy Analysis
Department of Taxation and Finance
State Campus
Bldg. 9, Room 227
Albany, NY 12227

Dear Mr. Plattner:

Thank you for the extraordinary work by you and the Department staff that went into the production of the revised outline for a new combined article of tax affecting corporate taxpayers, including banks, in New York State. The revision answers a number of challenging questions shared by our members during meetings over the past several months. Importantly, however, the tax rate selected on the very significantly broadened tax base under this proposal will be critically important to many of our members. In addition, while we are encouraged by the progress made, there remain several areas in which we believe the draft needs revision. We urge that the Department review these comments and consider amendments to the statutory language when available. Finally, while we certainly understand the Department's desire to include a draft of this legislation in the Executive Budget scheduled to be released in January, we continue to believe that timing should be dependent on achieving a fair and workable draft.

I. Add-Back for Interest Expense Associated with Unitary, but Non-Combined Subsidiaries

As we understand the current draft, a taxpayer with unitary subsidiaries that are not placed in the combined group, which would almost always be foreign affiliates, would be required to add back the interest expense associated with that portion of the value of the taxpayer's foreign subsidiaries, even if the taxpayer had little, if any, income from the non-combined subsidiaries. Thus, for example, if the value of the taxpayer's foreign subsidiaries represented 10% of the

taxpayer's total value, and the taxpayer had unitary, but non-combined subsidiaries that paid no dividends in a particular tax year, the taxpayer would still be required to add back 10% of its total interest expense, in effect increasing tax for New York State tax purposes where there is no corresponding exempt income.

As we understand this provision, it could result in the imputation of an enormous increase in entire net income and a concomitant increase in taxes where no income has in fact been realized. This effect would be particularly burdensome to taxpayers that have previously been taxed under article 32 of the Tax Law because banks and thrifts rely far more heavily on deposits to fund their operations than does any other type of taxpayer. Depository institutions by the nature of their business have a huge interest expense, generally the largest single expense of a depository institution taxpayer. The use of Edge Act or Agreement Corporations is a very common method for bank holding companies to engage in foreign operations, and this proposal does not take into account the expenses and normal operating procedures of these types of entities.

To address the inequity of this provision, we could support excluding a certain percentage of dividends from subsidiaries not included in the combined group from taxation. Our understanding is that most states currently allow a 100% exclusion for subsidiary dividends with no add-back for expenses. While we would certainly prefer such an exclusion, a slightly lower level of exclusion could also be acceptable, if appropriately drafted. We cannot stress highly enough the importance of this point to New York's continued position as a headquarters state.

II. Water's Edge Election

The original outline presented by the Department would have allowed taxpayers to elect between water's edge and worldwide unitary taxation. We would greatly appreciate an understanding of why the water's edge election was dropped. We urge the Department to reconsider a water's edge election as part of this legislation.

III. Concerns of Mortgage Lending Institutions

A major concern raised primarily by our community banks, but also by larger institutions that are heavily concentrated in mortgage lending, is whether the allocation rules for mortgage loans would result in mortgage portfolio lenders being subject to a much greater tax burden than under current law. Portfolio lenders are those lenders who make loans and keep them on their own books, rather than securitizing and selling them into the secondary market. As we understand the outline, loans made on the security of New York real estate and held in portfolio would be subject to 100% allocation to the State. This new allocation rule would hit portfolio lenders particularly hard, subjecting those

institutions that make and hold their mortgage loans to a potentially much higher tax than those who sell their loans into the secondary market. Community banks will be subject to the loss of many of the deductions and exclusions that have heretofore allowed their State tax bills to be manageable. Among these will be the REIT deduction, which provides significant tax incentives for New York portfolio lenders. A number of our members, in analyzing the effect of this proposal on smaller institutions, are concerned that it could increase their tax burden by 200-300 percent. We believe such an enormous increase in tax burden, particularly concentrated in one segment of the industry, would be a major disincentive to support for this legislation and would like to discuss with the Department further opportunities to craft a solution that would protect that State's revenue while not unduly burdening any one segment.

IV. Apportionment Factor Effects on Out-of-State Institutions

We are also concerned that the change in the factors governing apportionment, particularly for some out-of-State taxpayers that became subject to a significant tax increase as part of the unitary taxation of out-of-State credit card banks adopted last year, may dramatically increase the New York apportionment for some of these institutions. We have heard that New York apportionment could increase by a factor of three or four. Therefore, in our discussions with the Department, we would also like to get clarification of the impact of the changes in apportionment factors on certain institutions.

V. Net Operating Loss Carry-Over Provisions:

A number of the Department's proposed changes to the net operating loss (NOL) provisions of the revised outline are, in our opinion, very appropriate. The quantifying of the NOL, converting it into a credit and providing a twenty-year carry-forward are all very helpful. However, coupled with the 20-year carry-forward is a restriction that prevents the use of more than 1/20th of the carry-forward in any year, except to the extent that it had not been used in the previous year, and that causes any unused NOL to be exhausted at the end of the twentieth year. The issue is not the credit, but the deferral and spreading of the NOL over 20 years. We would respectfully suggest that the Department continue to provide a twenty-year carry-forward, but allow more than 1/20th of the credit to be used each year, perhaps as much as 1/10th or 1/15th of the available NOL. Thus, the NOL would be converted into a lump-sum credit and up to 1/10th of the credit could be used each year for up to 20 years, or until the credit expired or was exhausted, whichever came first.

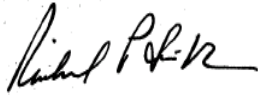
VI. Bad Debt Deduction for Savings Banks and Savings and Loan Associations

Based on our meetings, it is our understanding that the Tax Department has agreed to preserve a modification to income that is equivalent to the modification currently available under the reserve method for bad debts of Section 1453(h) of

New York Tax Law. This long standing feature of Article 32 has been reaffirmed many times by the Legislature.

We appreciate the attention the Department has given to these issues and look forward to working with you as the process of reforming the State corporate tax proceeds. We would greatly appreciate the opportunity, if available, to review any draft legislative language before it is included in the Executive Budget, in order to provide our views on its efficacy and balance. Please feel free to contact me or Bill Bosies of my staff if you have any questions.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael P. Smith". The signature is written in a cursive style with a prominent initial "M".

Michael P. Smith