LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

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FISCAL IMPACT STATEMENT

LS 6137 **DATE PREPARED:** Nov 2, 1999
BILL NUMBER: SB 99 **BILL AMENDED:**

SUBJECT: Financial Institutions Tax.

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FUNDS AFFECTED: **X** **GENERAL** **IMPACT:** State
DEDICATED
FEDERAL

Summary of Legislation: This bill treats resident financial institutions the same as nonresident financial institutions for purposes of the Financial Institutions Tax (FIT) by providing that the tax is imposed upon the apportioned Indiana income of financial institutions. (Current law imposes the financial institutions tax on the adjusted gross income of resident financial institutions.)

Effective Date: January 1, 1999 (retroactive).

Explanation of State Expenditures: The Department of State Revenue will have some administrative expenses associated with changing tax forms, instructions and computer programs to implement this change. These expenses will be covered under its existing budget.

Explanation of State Revenues: This bill changes to the way that Indiana domiciled companies are taxed under the FIT. This bill would make the apportionment rules apply to all financial institutions by using Indiana receipts compared to total receipts, sourced by customer location.

Under the current statute, there are two different formulas for calculating the FIT depending on where the financial institution is domiciled. For Indiana domiciled financial institutions, the tax base is calculated using total income earned in and out of state. FIT allows a credit to be taken for taxes paid to other states. This formula taxes all the resident's income at the Indiana tax rate. This was done to capture income earned in another state due to Indiana's application of "economic nexus" where another state would not tax that income because there was no "physical nexus." This is sometimes referred to as "no where income." It also negates the effects of a lower rate in another state. A second formula is used for financial institutions that are domiciled out of state. Currently, nonresident financial institutions use a one factor apportionment formula of receipts attributable to Indiana over total receipts.

The fiscal impact of changing the tax base of resident financial institutions to include apportioned Indiana receipts will affect FIT revenue in two ways. First, if one assumes that any institution which can now change their state of domicile to reduce their tax liability will do so under current law, then this change will not affect that eventual revenue loss. The state will only lose revenue from those Indiana banks that have income in states where their tax rate is lower.

Secondly, apportioning income will eliminate the state’s ability to use resident status to tax “no where income.” However under deregulation it appears that Indiana has already lost its ability to use resident status to tax “no where income” from the majority of financial institutions operating in Indiana and only the remaining state domiciled banks are including this income in their base. This has created a disadvantage for Indiana domiciled banks.

It is estimated that apportioning resident income will result in a *net* revenue loss of less than $5 M annually in FIT collections. This assumes that FIT collections will continue to be affected by deregulation absent this change and the additional loss of FIT would be from Indiana domicile banks who do not have enough of an incentive to change their state of domicile. This change is effective for tax years beginning January 1, 1999. The impact on revenue collections will begin in FY 2000. FIT revenue is deposited in the General Fund.

Background Information: According to the Department of Financial Institutions there were 151 state chartered financial institutions as of October 1, 1999. Forty banks have dissolved their state charter in the last three years due to mergers or conversions. With 651 FIT filers in FY 97, these state charter banks make up 23% of the number of financial institutions in the state. After review of the 1997 FIT returns, the DOR has determined that many of the large national banks are already apportioning their Indiana income and reporting as nonresident banks. This may be reflective in the decrease in FIT revenue over the last two fiscal years. FIT revenue was $100.7 M in FY 97; $95.6 M in FY 98; and $81.9 M in FY99.

Explanation of Local Expenditures:

Explanation of Local Revenues: Local units of governments are guaranteed a portion of the Financial Institutions Tax. This change will not affect the amount of revenue the locals receive from the guaranteed distribution.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected:

Information Sources: Department of State Revenue; Additional background information can be found in "Review of the Financial Institutions Tax structure in Indiana," Prepared for the Commission on State Tax & Financing Policy, October 12, 1999.