Exemptions-Banks-Banks-Operating

The "in lieu" exemption provided to banks applies as well to bank-operated businesses and to activities which are performed by a bank but are unrelated to the banking function. However, if the activities are conducted by a separate entity, even one wholly-owned by the bank, those activities are not covered by the "in lieu" exemption. 11/3/89.
Your memo of August 18, 1989 raises several questions concerning whether the (redacted) is subject to the fees imposed by the Health and Safety Code for the management of toxic and hazardous wastes. Specifically, the (redacted) is generating hazardous waste through its warehouse and industrial fleet, and you ask whether the (redacted)’s payment of the “in lieu” tax exempts it from payment of the hazardous waste fees, even though the wastes are generated by activities unrelated to banking.

The first question to be addressed is whether banks are subject to California’s hazardous waste fees, or escape the imposition of such fees by virtue of their payment of the “in lieu” tax described in Sections 23181 and 23182 of the Revenue and Taxation Code. The resolution of this issue must await the conclusion of our research and discussions concerning the liability of the federal government and its agencies and instrumentalities for the same fees. The definitions and implications of the use of such terms as “taxes”, “licenses” and “fees” are central to that discussion, and will also control our interpretation of Section 23182. If the various hazardous waste charges are determined to be taxes, then banks will not be required to pay them because the banks pay an “in lieu” tax instead. If, however, the charges are “fees”, then they do not come within the scope of Section 23182, and banks must pay them in addition to the “in lieu” tax.

Assuming that payment of the “in lieu” tax does relieve banks from responsibility for California’s hazardous waste fees, I will address the question of whether a bank must pay those fees when hazardous wastes are generated, stored, treated or disposed of by other businesses owned and operated by the bank.

The only California case that deals with this issue in the context of banking is Western States Bankcard Association v. City and County of San Francisco (1977) 19 C.3d 208. Western States Bankcard Association (WSBA) was a nonprofit California corporation organized by several national and state banks to administer their Mastercharge accounts by performing data processing and promotional functions for the member banks. WSBA requested a refund of the gross receipts and payroll expense taxes it had paid to the City and County of San Francisco, arguing that it was entitled to benefit of constitutional and statutory provisions which grant banks an “in lieu” exemption from local personal property and privilege taxes. The Court rejected WSBA’s claim, finding that the incidence of the taxes fell upon an independent entity, WSBA, rather than upon its member banks, and, furthermore, that the relationship between
WSBA and its members was not such as to justify disregarding its separate corporate status for tax purposes. The Court noted that WSBA was not a bank, but a nonprofit institution organized and operated for banking purposes. In addition, WSBA, as a corporation, was entitled to benefits not available to banks, such as the right to hold and deal with real property, free of the restrictions imposed upon banks.¹

Western States Bank Association involved a separate corporation organized by a group of banks to provide certain services to the member banks.² However, the application of the “in lieu” exemption to non-banking activities carried out by the bank itself, rather than a separate entity, can be discussed with reference to recent California cases involving insurance companies, which also pay an “in lieu tax”.

First, in Massachusetts Mutual Life Insurance Co. v. City and County of San Francisco (1982) 129 Cal.App.3d 876, an insurance company owned a hotel which was operated and managed by another entity pursuant to a lease. Although the California Constitution provides that insurance companies pay an annual tax on “gross premiums” in lieu of all other taxes and licenses except real estate taxes, the court found that San Francisco could tax the profits realized in the hotel operation. The court noted that the “in lieu” exemption was granted in return for imposition of a tax on gross, rather than net, receipts. Therefore, in order to implement the policy underlying the constitutional provision, an insurance company should not receive the “in lieu” exemption for property it owns and uses in the operation of an active business that generates gross operating revenues as opposed to gross insurance premiums, unless the business is reasonably related or incidental to traditional insurance industry activities. Since the operation of the hotel was not the type of passive investment traditional in the insurance business, the court held that the “in lieu” exemption did not apply to profits generated by the hotel.

Several years later, however, another California appellate court reached a contrary result in Mutual Life Insurance Company of New York v. City of Los Angeles (depublished). In that case, the insurance company sued for a refund of certain taxes Los Angeles imposed on two parking lots it owned and operated. The company argued that the parking lots were part of its overall investment plan and the type of investment traditionally associated with the insurance business. The Court, however, saw no

¹ See also, First National Bank of Santa Fe v. Commissioner of Revenue, 460 P.2d 64 (N. Mex. 1969), where the bank provided an electronic processing service for four other banks. Despite the then-existing restrictions on state taxation of federal banks, the Court found that the bank had to pay state tax on the gross receipts of the bookkeeping services it performed for the other banks. The Court held that the determination of whether a tax is permissible should be based on whether the act or service involved is reasonably related to or incidental to the accomplishment of bank functions.

² See also, Arizona State Tax Commission v. First Bank Building Corporation, 429 P.2d 481 (Ariz., 1967), where the state assessed various taxes against the rental receipts a corporation received from several properties it owned. The corporation, and hence the properties, were owned by a national bank, which claimed that it was exempt from the taxes. The Court disagreed, noting that the corporation was a separate entity which enjoyed the benefits of corporate existence, even though it performed functions of importance as a subsidiary of a national bank.
need to scrutinize the nature of the business, and instead relied on the “ordinary and usual” meaning of the words used in the Constitutional “in lieu” tax exemption provision. Since there was no ambiguity in the Constitutional language, the Court found that it had no authorization to exclude an insurer’s investments because they were incidental to the insurance enterprise, even though a tax windfall to the insurer might result.

The Mutual Life Insurance Company case is currently on appeal to the California Supreme Court. To date, the State Board of Equalization has followed the rationale set forth by the appellate court and has permitted insurance companies to claim the “in lieu” exemption concerning activities not traditionally associated with the insurance business. The Board will continue to follow this course until the Supreme Court issues its decision.

Therefore, unless an operation is a separate legal entity, as in Western States Bankcard Association, the “in lieu” exemption provided to banks by the California Constitution and statutes applies as well to bank-operated businesses and activities which are performed by a bank but are unrelated to the banking function.

Janet Vining

JV:wak
1630C

Cc:   Mr. E. V. Anderson
      Mr. Gary J. Jugum
      Mr. Donald J. Hennessy
      Mr. E. L. Sorensen, Jr.
      Mr. Gordon Adelman