

FEDERAL RESERVE BANK
OF NEW YORK

Circular No. 8015
December 20, 1976

BANK HOLDING COMPANIES

Tax Relief for Divestitures under the Bank Holding Company Act

*To All Bank Holding Companies, and Others Concerned,
in the Second Federal Reserve District:*

In a letter to the Presidents of all Federal Reserve Banks, dated December 14, 1976, the General Counsel of the Board of Governors of the Federal Reserve System has provided important information regarding certain tax relief available under the Bank Holding Company Tax Act of 1976 in connection with divestitures by companies that became subject to the Bank Holding Company Act as a result of the 1970 Amendments. *Bank holding companies that may be eligible for tax relief for divestitures that have already occurred or that will be completed before December 31, 1976, must apply to the General Counsel of the Board of Governors prior to December 31, 1976, for certain certifications required under the Bank Holding Company Tax Act of 1976.*

Following is an excerpt from the General Counsel's letter of December 14 to the Presidents of all Federal Reserve Banks:

On October 2, 1976, Congress enacted the Bank Holding Company Tax Act of 1976 (§§ 1101-1103 and 6158 of the Internal Revenue Code) ("Tax Act"), which provides certain tax relief for divestitures required of companies that became subject to the Bank Holding Company Act ("BHC Act") as a result of the 1970 Amendments. These companies are generally required to divest either their impermissible nonbanking assets or their control of banks prior to January 1, 1980. But for the Tax Act, many such divestitures would result in additional Federal taxes for the divesting companies or their shareholders.

In general, the Tax Act provides two possible methods through which tax relief may be obtained by a bank holding company and its individual security holders. Under one method, a bank holding company may divest either banking or nonbanking property (or the stock of a new subsidiary corporation formed to hold such property) through the distribution (or "spinoff") of such property to its security holders without creating taxable income or causing the recognition of gain by those security holders with respect to the property distributed. In effect, the basis of such property for tax purposes is shifted from the holding company to the recipient security holders, who will recognize gain, if any, upon their sale or disposition of such property. Such a distribution may be made in exchange for certain types of securities of the divesting company held by the company's security holders.

Under a second method of tax relief, a bank holding company may divest either its banking or nonbanking property through a taxable sale or exchange and may pay the tax incurred in installments over a ten-year period.

In addition to the tax relief available for divestitures compelled by the 1970 Amendments to the BHC Act, the Tax Act affords an opportunity for bank holding companies covered by the 1970 Amendments that have permanently grandfathered activities to dispose voluntarily of either all of their grandfathered holdings or all of their banking property and obtain the same tax advantages for those dispositions that are applicable to forced dispositions.

As a prerequisite to obtaining any of these benefits, the Tax Act requires the divesting company to obtain from the Board certain "certifications" with respect to the company involved and the relationship of the divestiture to the requirements of the BHC Act. In essence, the purpose of these certifications is to provide assurance, based upon the Board's knowledge of the purpose of the BHC Act and its familiarity with specific circumstances, that the tax relief provided will be justified in each situation.

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The certifications that the Board must make in order to qualify a divestiture for tax relief fall into two categories: A "prior certification," which must be made before a divestiture takes place, and a "final certification," which must be made after the holding company completes its divestiture. In issuing a "prior certification" with respect to a proposed divestiture of nonbanking property, the Board must certify that "the distribution of such prohibited property is necessary or appropriate to effectuate section 4 of the Bank Holding Company Act." In issuing a "prior certification" with respect to a proposed divestiture of banking property, the Board must certify: (1) that such property is all or part of that which causes the company to be a bank holding company, and (2) that "the distribution is necessary or appropriate to effectuate the policies of the (BHC) Act."

Before a company or its shareholders can take advantage of the Tax Act's benefits, the Board must issue a "final certification" that the divesting company has either "disposed of all of the property the disposition of which is necessary or appropriate to effectuate section 4 of the Bank Holding Company Act," or "ceased to be a bank holding company."

In connection with the issuance of "prior" and "final" certifications, the Board is also required to certify that the divesting company constitutes a "qualified bank holding corporation," as defined in §§ 1103(a)(1), (2) and (3) of the Tax Act, and to specify and itemize the property being disposed of. In addition, the Board may be called upon to make certain other certifications relating to a divestiture. These include certifications with respect to whether a distribution may be made on a *non-pro rata* basis under § 1101(a)(3)(D) of the Tax Act; and, if applicable, whether the divesting company has disposed of all "grandfathered" property as required under § 1103(g) of the Tax Act.

The provisions of the Tax Act become effective on October 1, 1977. However, the Tax Act provides that in the event a company has already completed a divestiture pursuant to the 1970 Amendments, or completes such a divestiture by December 31, 1976, a subsequent certification by the Board shall be deemed to satisfy the requirements relating to both "prior" and "final" certifications if an application for such certification is made within 90 days of the enactment of the Tax Act — that is, no later than December 31, 1976. *Thus, bank holding companies that may be eligible for tax relief for divestitures that have already occurred or that will be completed before December 31, 1976, should be aware of the need to apply for the necessary certification prior to December 31, 1976.*

The Board has delegated to the General Counsel the authority to issue certifications under the Tax Act. All requests for certifications by companies that must apply before the December 31, 1976 deadline should be sent in duplicate directly to the General Counsel of the Board with a copy to the Federal Reserve Bank of the Federal Reserve District in which the principal banking operations of the holding company are conducted. The request should be in letter form specifying the certifications requested, and should set forth (1) the facts upon which the applicant's eligibility for tax relief is based; (2) the property that has been divested, or will be divested by December 31, 1976; and (3) the method of divestiture. While timely applications setting forth this information will be deemed to satisfy the statutory requirement for filing prior to December 31, 1976, applicants should understand that additional information may be required to enable the Board to issue the certifications requested.

The December 31, 1976 deadline for applying for certifications is applicable only to companies that will have *completed* divestitures by that date. In the near future more detailed procedures for applications for certifications by other companies eligible for tax relief under the Tax Act will be made available. However, bank holding companies planning divestitures early in 1977 are advised to file letter applications promptly without awaiting the promulgation of further procedural requirements.

Companies that conduct their principal banking operations in the Second Federal Reserve District and that must apply for certifications before the December 31, 1976 deadline should send two copies of the application directly to the General Counsel of the Board of Governors and one copy to the Domestic Banking Applications Department of this Bank.

Questions regarding this matter may be directed to our Domestic Banking Applications Department.

PAUL A. VOLCKER,
President.