

FEDERAL RESERVE BOARD

WASHINGTON

August 1, 1922.
X-3492

SUBJECT: Franchise Taxes, Surplus funds, and depreciation charges.

Dear Sir:

With reference to the Board's letter X-3462 of June 29, 1922, enclosing a copy of Counsel's opinion dated June 5, 1922, regarding the proper method of building up surplus funds by Federal Reserve Banks and of determining the amount of franchise taxes payable to the U. S. Government, you are advised that in accordance therewith, those banks which transferred amounts to supersurplus account on December 31, 1920 should recalculate the amount of franchise taxes payable to the Government and the amount transferable to surplus account.

In view of the ruling that the supersurplus account is a bookkeeping entry only and that the law contemplates only one surplus fund, all charges heretofore made against supersurplus account to cover depreciation on bank premises or for reserves for undetermined liabilities, should be reversed. No charges against the normal surplus or supersurplus will be authorized in the future to cover depreciation on bank premises or for the purpose of setting up special reserves, as such charges if made might affect amounts subsequently payable to the Government as franchise taxes.

For your information there is enclosed herewith a statement which shows the necessary adjustments to be made by each Federal Reserve Bank in order that the correct amount may be paid to the Government as a franchise tax and proper credit made to surplus account. It will be appreciated if you will kindly have the figures checked so far as they relate to your Bank, and advise the Board at your early convenience as to whether or not you find them correct. The amounts payable to the Government on account of franchise taxes due for former years should be charged to surplus account on December 31, 1922 before closing of books, and paid to the U. S. Government in accordance with instructions to be issued at a later date.

In view of the fact that no depreciation charges will be made against supersurplus, the Board will review before the end of this year the policy which has been pursued heretofore with reference to depreciation charges on bank premises. It is accordingly desired that your requests for authority to charge off depreciation on bank premises, or to set up a reserve for depreciation, be accompanied with a statement in a form similar to that indicated below, showing separately for the head office and each branch, the cost, estimated market value, and book value (less reserves) of land owned, and the cost to date, estimated replacement cost, and book value (less reserves) of new buildings, either completed or in course of construction, or of remodeled buildings.

LAND

Cost	\$ _____
Estimated market value	_____
Book value (net)	_____

	<u>TOTAL</u>	<u>BUILDINGS IN- CLUDING VAULTS</u>	<u>FIXED MACHINERY AND EQUIPMENT</u>
<u>BANKING HOUSE</u>			
Cost to date	\$ _____	\$ _____	\$ _____
Estimated replacement cost	_____	_____	_____
Book value (net)	_____	_____	_____

In passing upon requests to set up depreciation reserves or to charge off depreciation allowances, the Board will in general permit a charge against current net earnings of not exceeding 2 per cent of the estimated replacement cost of bank buildings, including vaults but excluding fixed machinery and equipment. In case, however, the estimated replacement cost is considerably below the book value, the Board will consider requests from Federal Reserve Banks for permission to write off a depreciation charge in excess of 2 per cent.

The estimated replacement cost, less residual value, of fixed machinery and equipment, such as boilers, engines, dynamos, motors, power pumps, elevators, heating, plumbing, lighting and ventilating systems, pneumatic tubes, refrigeration plants, automatic fire sprinkler equipment, and vacuum cleaners, should be determined and a reserve set aside each year out of current net earnings to cover replacements. Annual additions to this reserve should be based on the estimated life of the machinery and equipment, with a view to the ultimate replacement of the machinery and equipment, but shall in no case exceed 10 per cent of the cost thereof.

No charges against current net earnings will be authorized by the Federal Reserve Board to cover depreciation on land where the estimated market value of the land is equal to or in excess of its net book value.

The estimate of the market value of land and of the replacement cost of buildings either completed or in course of construction and of fixed machinery and equipment, should be obtained from the best available authorities and a copy of the estimates thus obtained enclosed with your request for authority to charge current net earnings with depreciation on bank premises. The estimated replacement cost of buildings including vaults, but excluding fixed machinery and equipment, may be arrived at by determining the mean of two amounts, namely; (1) the total actual cost of construction, and (2) the estimated cost of construction based on the lowest prices that have existed during the last fifteen years.

Where properties have been purchased with the intention of razing existing buildings and of erecting new banking quarters the Board will consider requests for permission to deduct from current net earnings an amount equal to the difference between the cost of the property and the market value of the building site exclusive of improvements.

Advance approval of the Federal Reserve Board shall be obtained for all depreciation and other charges against current net earnings whether in connection with bank premises as outlined above or for other purposes.

Very truly yours,

G o v e r n o r .

LETTER TO ALLCHAIRMEN.

ADJUSTMENTS TO BE MADE IN SURPLUS ACCOUNTS AT END OF 1922 AND ADDITIONAL AMOUNTS
PAYABLE TO UNITED STATES GOVERNMENT AS FRANCHISE TAXES FOR FORMER YEARS.

Federal Reserve Bank	Amounts previously charged to supersurplus to be credited to surplus fund and debited to account originally credited as follows -				Amount to be charged to surplus fund and paid to U. S. Government as franchise tax for former years	Total surplus fund (revised) on Dec. 31, 1922 before closing of books
	Total	Bank premises account	Depreciation reserve on bank premises	Reserve for undetermined liabilities		
Boston	\$	\$ -	\$ -	\$ -	\$ 247,349.91	\$ 16,235,807.79
New York	1,000,000	-	-	1,000,000	1,604,549.37	59,592,577.77
Philadelphia	-	-	-	-	36,366.25	17,908,779.79
Cleveland	125,000	125,000	-	-	-	22,634,279.19
Richmond	225,276.50	225,276.50	-	-	20,459.01 ^{8.51}	11,234,665.60
Atlanta	-	-	-	-	213,628.77	8,899,942.22
Chicago	2,030,000	-	2,030,000	-	710,189.99	30,345,275.43
St. Louis	-	-	-	-	-	9,388,223.25
Minneapolis	-	-	-	-	52,423.36	7,416,054.44
Kansas City	-	-	-	-	208,169.99	9,437,561.82
Dallas	-	-	-	-	-	7,394,097.30
San Francisco	250,000	-	250,000	-	306,925.46	15,142,126.72
TOTAL	\$ 3,630,276.50	\$350,276.50	\$ 2,280,000	\$ 1,000,000	\$ 3,400,062.11^{1.61}	\$215,629,391.32