

FEDERAL RESERVE BOARD

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WASHINGTON

ADDRESS OFFICIAL CORRESPONDENCE TO
THE FEDERAL RESERVE BOARD

X-7703

December 8, 1933.

Dear Sir:

There is inclosed herewith a copy of a letter addressed by the Board on December 5, 1933, to Mr. Harris Creech, President of the Cleveland Clearing House Association, Cleveland, Ohio, with regard to the absorption by member banks in Ohio of the tax levied by the State on deposits in such banks. It will be noted that the ruling set forth in the letter is applicable also to member banks in Kentucky and other States having similar laws regarding the taxation of bank deposits on an ad valorem basis, and that it supersedes the ruling contained in X-7602, dated September 21, 1933.

Very truly yours,



Chester Morrill,
Secretary.

Inclosure.

TO ALL FEDERAL RESERVE AGENTS.

C O P Y

X-7703-a

December 5, 1933.

Mr. Harris Creech, President,
Cleveland Clearing House Association,
706 Federal Reserve Bank Building,
Cleveland, Ohio.

Dear Mr. Creech:

This refers to your letter of October 13, 1933, requesting a ruling of the Federal Reserve Board on the question whether that provision of section 19 of the Federal Reserve Act, as amended by the Banking Act of 1933, which provides that, "No member bank shall, directly or indirectly by any device whatsoever, pay any interest on any deposit which is payable on demand", prevents Ohio banks from continuing their present practice of absorbing and paying the Ohio two mill tax upon deposits as an operating expense of each bank.

A ruling upon this question has been delayed by the fact that it bore a very close relation to another question pending before the Board which was of general importance and some difficulty and which required extensive investigation and numerous conferences before it could be disposed of; and it was felt that both questions should be considered together.

The Board has heretofore ruled that the absorption by a member bank of taxes levied by the State of Kentucky upon deposits and paid by such bank "for and on behalf, and as the agent",

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of its depositors would constitute an indirect payment of interest within the meaning of section 19 of the Federal Reserve Act, as amended, since the amount of the tax paid by such member bank represented a fixed percentage of the depositors' balances. It was necessary for the Board to reconsider that ruling in the light of the brief filed by your counsel; because the practical effect of the Kentucky statutes regarding taxes on bank deposits seems to be substantially the same as that of the Ohio statutes on this subject.

Upon a careful reconsideration of this subject, in the light of the brief filed by Counsel for the Cleveland Clearing House Association, the Federal Reserve Board has reached the conclusion that the absorption of such taxes should not be regarded as an indirect payment of interest within the meaning of section 19 of the Federal Reserve Act, as amended; because such taxes represent a certain percentage of the funds on deposit on a single day of the tax year and have no relation either to the average amount on deposit for any given period of time or to the length of time for which the bank has the use of the money. These considerations and other considerations pointed out by your counsel make the absorption of such taxes distinguishable from the absorption of such items as exchange and collection charges in an amount equal to a fixed percentage of a deposit balance, which has been held by the Federal Reserve Board to be an indirect payment of interest contrary to section 19 of the Federal Reserve Act.

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The Federal Reserve Board is of the opinion, therefore, that the absorption by member banks in Ohio of the Ohio two mill tax upon deposits as an operating expense of each bank does not, in itself and in the absence of special factors in particular cases which might indicate the contrary, constitute a payment of interest by such banks and is not inconsistent with that provision of section 19 of the Federal Reserve Act which forbids any member bank, directly or indirectly by any device whatsoever, to pay any interest on any deposit which is payable on demand. The Board is also of the opinion that the amount of taxes so absorbed need not be taken into consideration in determining whether member banks are paying interest on time deposits at a rate in excess of the limitations prescribed by the Federal Reserve Board, pursuant to that provision of section 19 of the Federal Reserve Act which requires the Federal Reserve Board from time to time to limit by regulation the rate of interest which may be paid by member banks on time deposits.

This ruling is also applicable to member banks in Kentucky and other states having similar laws regarding the taxation of bank deposits on an ad valorem basis.

Very truly yours,

(Signed) Chester Morrill

Chester Morrill,
Secretary.