**IN THE**
**SUPREME COURT OF MISSOURI**

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**No. SC86932**

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**MIDWEST ACCEPTANCE CORPORATION,**

**Appellant,**

**v.**

**DIRECTOR OF REVENUE,**

**Respondent.**

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**Petition For Review**
**From The Administrative Hearing Commission,**
**The Honorable June Striegel Doughty, Commissioner**

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# APPELLANT'S BRIEF

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## JURISDICTIONAL STATEMENT

This case is a petition for judicial review from a decision of the Missouri Administrative Hearing Commission rendered pursuant to § 621.050, RSMo, finding that Petitioner, Midwest Acceptance Corporation was not entitled to a credit against its Missouri Credit Institutions tax for the income taxes paid by its shareholders or for the Missouri income tax it would have paid if it had been organized as a C corporation.

Midwest Acceptance Corporation operates a consumer lending business in St. Louis and is organized as a Subchapter S corporation. The basis for the AHC's decision was its interpretation of the Credit Institutions Act of 1946, specifically § 148.140.3, which provides for a credit against the credit institutions tax for all other taxes paid to Missouri and its political subdivisions, holding that because the shareholders paid the income taxes in question that no credit was available to the credit institution. Jurisdiction is proper in this Court because this appeal involves the construction of one or more revenue laws of this state contained in the Credit Institutions Tax Act of 1946. Mo. Const. Art. V, § 3; § 621.189, RSMo.

## STATEMENT OF FACTS

Midwest Acceptance Corporation (hereinafter "MAC") operates a consumer business from an office located in St. Louis, Missouri. (L.F. 103) Specifically, MAC is defined as a "credit institution" under §§ 148.120 to 148.230 otherwise known as the "Credit Institutions Tax Law of 1946." As a Missouri credit institution, MAC is subject to the Missouri financial institutions tax imposed by Chapter 148, RSMo. The facts in this case are not really in dispute, the facts which follow are taken from the AHC's decision unless otherwise noted. (L.F. 223-25).

This case involves the total amount of tax liability owed to the State of Missouri on the income earned by MAC, an S corporation, for its 2004 Credit Institutions tax. As an S corporation, all of the taxable income of MAC is treated as though distributed to its shareholders each year in the form of dividends regardless of the amount of actual distributions to the shareholders. On its 2004 credit institutions tax return (Missouri Form 2823), MAC claimed a credit against its Missouri credit institutions tax for the amount of Missouri corporate income tax MAC would have owed if MAC had been organized as a "C" corporation rather than an S Corporation. This credit was claimed on line twenty of MAC's 2004 Missouri form 2823.

The Director of Revenue audited MAC's 2004 form 2823 and disallowed the credit claimed on line twenty and assessed MAC a deficiency in the amount of

$54,486 plus interest. MAC timely protested the Director's notice which appeal was denied by the Director. MAC appealed to the AHC.

Before the AHC, the Director filed a Motion for Summary Determination, MAC filed a Cross Motion for Summary determination and the Director filed her Response to MAC's Cross Motion for Summary Determination. (L.F. 62, 162 & 212). The AHC rendered a decision in favor of the Director finding that § 148.140 limited the tax credits available to MAC to taxes paid directly by MAC to the state or its political subdivisions and could not include either taxes paid by its shareholders, or a proforma tax computation made as though MAC had elected "S" corporation status and had filed a Missouri income tax return on that basis. MAC appeals the AHC's decision to this Court.

## POINT RELIED ON

**The AHC erred in denying MAC a credit for the Missouri individual income taxes paid by its shareholders on the income they received from MAC or, alternatively, upon the Missouri corporate income tax that MAC would have paid had it been organized as a C corporation because its decision was not authorized by law and was contrary the reasonable expectations of the general assembly in that tax statutes applicable to financial institutions need to be read in pari material with the other tax laws so as to implement the general assembly's purpose of creating tax parity among financial institutions.**

*Mercantile Bank Nat'l Ass'n v. Berra*, 796 S.W.2d 22 (Mo. banc 1990)

*Merchants' Nat'l Bank v. Richmond*, 256 U.S. 635 (1921)

*Crown Finance Corp. v. McColgan*, 144 P.2d 331 (Ca. 1943)

§ 5219 Revised Statutes of the United States

*Verbatim Stenotype Transcription of Debates*, 1943-1944 Mo. Const. Convention

## ARGUMENT

The AHC erred in denying MAC a credit for the Missouri individual income taxes paid by its shareholders on the income they received from MAC or, alternatively, upon the Missouri corporate income tax that MAC would have paid had it been organized as a C corporation because its decision was not authorized by law and was contrary the reasonable expectations of the general assembly in that tax statutes applicable to financial institutions need to be read in pari material with the other tax laws so as to implement the general assembly's purpose of creating tax parity among financial institutions. The issue presented for this Court's consideration is whether the AHC's interpretation of the law was correct. Therefore, this Court's review of the AHC's interpretation of the law should be de novo. *Emerson Electric Co. v. Director of Revenue*, 133 S.W.3d 31, 32 (Mo. banc 2004); *see also Gott v. Director of Revenue*, 5 S.W.3d 155, 158 (Mo. banc 1999)("this Court owes no deference to the AHC's decisions on questions of law, which are matters for this Court's independent judgment").

### I. Introduction.

The Missouri Credit Institutions Tax Law of 1946, comprising §§ 148.120 to 148.230[1], remains essentially the same today as when it was drafted sixty years

[1] All section references are to RSMo. (2000) unless otherwise noted, except references to "§ 5219" which refers to the Revised Statues of the United States.

ago. The two primary sections of this law to be interpreted in this case have not been amended during the last fifty-six years.[2] One cannot understand either the Missouri Credit Institutions Tax Law or Chapter 148 as a whole without first examining the history of taxation of national banks and specifically tracing the history of section 5219 of the United States Revised Statutes (later 12 U.S.C. § 548). This historical detour is necessary in order to understand the General Assembly's intent because when these laws were drafted (1945), the federal government imposed numerous restrictions upon Missouri's ability to tax financial institutions. It is only when these restrictions are keenly examined in their historical context that one can begin to understand the intricate balancing act that the legislature was attempting to accomplish when these laws were forged. To look merely at a single law or two laws outside of the historical context, as the AHC chose to do in reaching its decision, is to miss the true purpose which the legislature sought to accomplish—the creation of tax parity among financial institutions in the State of Missouri. While there has never been any judicial interpretation of the two statutes at issue in this matter, the history of the taxation of both national banks and state banks, discussed later in this brief, sheds

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All Article references are to the 1945 Missouri Constitution, as amended, unless otherwise noted.

[2] Section 148.130 has not been amended since it was originally drafted in 1945, and § 148.140 has not been amended since 1949.

considerable light upon the intent of the legislature when it created the Credit Institutions Tax Law of 1946.

As interpreted by the AHC, § 148.140 imposes a significantly higher tax burden on credit institutions organized as "S" corporations or partnerships than Missouri law imposes upon other financial institutions. The AHC's decision relies heavily on this Court's decision in *Centerre Bank of Crane v. Director of Revenue*, 744 S.W.2d 754, 759 (Mo. banc 1988) for the proposition that MAC should not be granted a tax credit for the income taxes paid because the legal incidence of the income tax for which it seeks a credit does not fall on MAC. Appellant respectfully disagrees with the AHC's conclusion because it failed take into consideration the legislative purpose in creating the credit mechanism found in § 148.140.3—to maintain tax parity among Missouri financial institutions.

Missouri has always sought to pursue a policy of tax parity between state banks and national banks, and because the tax structure for taxing credit institutions is identical to the tax structure for banks, it is clear that the legislature intended to extend the tax parity conferred upon state banks vis-à-vis national banks to state credit institutions. As will be more fully discussed herein, the Missouri General Assembly would have felt compelled by federal law to insure that state credit institutions were taxed in the same manner and to the same extent as national banks just as it was compelled to do the same for state chartered banks. The reason for this pressure being placed on the state's ability to tax financial institutions was the federal government's restrictions on the taxation of national

banks. To offset this pressure on state financial institutions, the General Assembly allowed financial institutions a tax credit for other taxes paid to the state applicable against the taxes imposed by Chapter 148. This credit mechanism was intended to insure that Missouri's financial institutions were not placed at a tax disadvantage vis-à-vis the national banks.

## II. Principles of Statutory Interpretation.

In finding that § 148.140.3[3] does not allow MAC a tax credit, the AHC appears to have looked primarily at the text of this section and to the definitions in § 140.130, specifically the definition of "taxpayer" in reaching its conclusions regarding the applicability of a credit against MAC's credit institutions tax liability.[4] MAC asserts that while the conclusions reached by the AHC represent one possible interpretation of these statutes, that the AHC's interpretation does not take into account the overarching legislative purpose of the Act and thereby

[3] "Each taxpayer shall be entitled to credits against the tax imposed by sections 148.120 to 148.230 for all taxes paid to the state of Missouri or any other political subdivision thereof during the relevant income period, other than taxes on real estate, contributions paid pursuant to the unemployment compensation tax law of Missouri and taxes imposed by said sections." § 140.140.3.

[4] "The term taxpayer" means any credit institution subject to any tax imposed by sections 148.120 to 148.230." § 148.130(6).

reaches a conclusion at odds with the reasonable expectations of the General Assembly.

In crafting Chapter 148, the General Assembly was attempting to create tax parity among competing financial institutions in the face of severe restrictions on the taxation of one of these competitors the national banks. The AHC should have considered whether the conclusion it reached could be harmonized with the legislature's purpose of creating tax parity among competing financial institutions. *State Ex. Rel. Kemp v. Hodge*, 629 S.W.2d 353, 358 (Mo. banc 1982)(the primary rule of statutory construction is to ascertain and give effect to the legislative intent in doing so the court must look to the object to be accomplished and the problems to be remedied by the statute); *see also McCormack v. Stewart Enterprises, Inc.*, 916 S.W.2d 219, 225 (Mo. App. 1995)(provisions of a legislative act are to be construed together and read in harmony whenever possible, hence, a section of an act should not be considered in isolation but as part of the entire act). Appellant asserts that the AHC's interpretation failed to take into consideration the intent behind the General Assembly's reformulation of the tax laws pertaining to financial institutions when it created Chapter 148.

In addition, the AHC's decision failed to take into account how the income tax laws of Chapter 143 interact with the financial institutions tax in the case of S corporations to unjustly tax MAC and its shareholders, and thereby throw out of kilter the tax parity which the General assembly sought to create among competing financial institutions. *See State Ex. Rel. Kemp v. Hodge*, 629 S.W.2d 353, 359

(Mo. banc 1982) wherein the Court states: "Another basic principle of statutory construction is that statutes relating to the same subject matter . . . are in pari material and should be construed together. Therefore we should apply a rule of statutory construction which proceeds upon the supposition . . . [that these statutes] were governed by one spirit and policy and were intended to be consistent and harmonious in their several parts and provisions . . . the law favors constructions [of statutes] which harmonize with reason, and which tend to avoid unjust, absurd unreasonable . . . results. . .." (citations omitted). Applying these rules to the instant case, MAC believes the AHC should have considered not just the language of § § 148.140.3 and 148.130(6) in determining whether or not MAC was entitled to a tax credit because by failing to examine the more grandiose plan which the legislature created, the AHC erred in that its decision frustrates the legislature's intent to create tax parity The credit provision in § 148.140.3 was intended to allow credit institutions to be on a level playing field tax-wise with other financial institutions. The legislature's intent was that financial institutions were going to thrive or fail based upon the business acumen of the principals, not based upon a tax advantage or disadvantage imposed by Jefferson City.

## III. History of Taxation of National Banks.

From 1864 when the national banking system was reconstituted until 1969 the federal government tightly controlled the states' ability to tax national banks.[5] The national banks were considered to be instrumentalities of the federal government even though funded by private capital. As such, the federal government strictly limited the manner in which the states could impose taxes upon them. *See Agricultural Bank v. State Tax Comm'n*, 392 U.S. 339, 341-46 (1968).

Until 1923, the only permissible method for a state to impose a tax upon the national banks was to impose a share tax based upon the value of this intangible property.[6] States were also allowed to tax the real estate owned by national banks. In 1923, section 5219 was amended to allow states to impose one of three alternative methods of taxation upon national banks: (1) the traditional share tax,

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[5] In 1969, Congress greatly simplified 12 U.S.C. § 548 such that the only remaining restriction on the states' abilities to tax national banks was that the tax treatment had to be identical to the tax treatment of state banks. See Public Law 91-156 91st Congress. For the legislative history of the 1969 law changes See Act of December 24, 1969, Pub. L. No. 91-156, 1969 USCAN 1594(provides insights into Congress' reasons for removing most of the restrictions on the taxation of national banks but requiring the states to treat the national banks as if they were state chartered banks for tax purposes).

[6] See *Buder v. First National Bank*, 16 F2d 990, 993 (8th Cir. 1927).

(2) a tax on the dividends paid by the national banks to their shareholders or (3) a tax on the income of the banking corporation. The only exception to these mutually exclusive methods of taxation was that if a state chose method three and also imposed a similar tax on mercantile corporations and a tax on dividends of mercantile corporations in conjunction with the corporate level tax, such a state could tax national banks on their corporate income while at the same time imposing its individual income tax upon the dividends of the shareholders.[7] The legislative history of § 5219 suggests that the intent was to allow states with income taxes on both individuals and corporations to tax national banks in the same manner and to the same extent as other corporations.[8]

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[7] See *Buder v. First National Bank*, 16 F2d 990, 991 (8th Cir. 1927).

[8] See 67 Cong. Rec. 5261 (1926)(here again the consideration was tax parity: allow states that had adopted an income tax—not many had them back then—to tax banking corporations in the same manner as other mercantile corporations). However, this was still not true tax parity since it only created income tax parity. Federal law still precluded states from imposing a personal property tax on national banks so that states which did convert to taxing national banks on an income basis found the this method still did not create tax parity with other corporations which did pay personal property taxes.

Section 5219 was amended for a second time in 1926 to add a fourth alternative means for taxing national banks.[9] This time Congress permitted states the additional option to tax national banks using a franchise tax measured by net income.[10] This fourth method allowed the states to include in the measure of the tax otherwise exempt obligations. See *Flint v. Stone Tracy*, 220 U.S. 107, 163-64 (1911)("the measure of such tax may be the income from the property of the corporation, although a part of such income is derived from property in itself non-taxable. The distinction lies between the attempt to tax the property as such and to

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[9] *See Agricultural Bank v. Tax Comm'n*, 392 U.S. 339, 344-46 (1968) for a concise history of 12 U.S.C.A. § 548's restrictions on the ability of the states to tax national banks.

[10] *See Union Oil Associates v. Johnson*, 2 Cal.2d 727, 732, 43 P2d 291 (CA 1935). "Method four" as it became known allowed the indirect taxation of otherwise exempt federal obligations. This was especially important to the states because much of the capital of the national banks was required to be invested in government obligations. *See Mercantile Bank v. New York*, 121 U.S. 138, 155 (1887)("The capital of [the national banks] was to be furnished entirely by private individuals; but, for the protection of the government and the people, it was required that this capital, so far as it was the security for circulating notes, should be invested in the bonds of the United States").

measure a legitimate tax upon the privileges involved in the use of such property").[11]

In addition to providing for these four alternative methods of taxation applicable to national banks, § 5219 also contained further restrictions upon how the national banks could be taxed in relation to other taxpayers. These restrictions are critically important because they provide insight into the limitations which the framers of the Missouri Constitution of 1945 and the Missouri General Assembly of 1945 were faced with when crafting Missouri's new tax scheme for financial institutions (Chapter 148). The first of these restrictions was tied to method one

[11] For a much more in depth look into the 1920s amendments to § 5219 and the impact upon the states' budgets and much more importantly, the restrictions that the states perceived were created by these amendments and the Supreme Court's decisions in *Merchants' National Bank v. Richmond*, 256 U.S. 635 (1921) and *First National Bank of Hartford v. City of Hartford*, 273 U.S. 548 (1927)(one of three cases issued in 1927 suggesting that the competition from which Congress sought to protect national banks against was not limited to state chartered banks) see State Taxation of National Banks, Hearings on H.R. 8727 before the House Committee on Banking and Currency, 70th Congress, First Session (May 27-28, 1928).

for taxing banks, the traditional share tax methodology.[12] The restrictive language of §5219 was that the taxation of national banks could not be at a greater rate than was assessed upon other moneyed capital in the hands of individual citizens.[13] Over the time period from 1864 to 1921 states had come to assume that this restriction meant only that state banks could not be taxed more favorably than national banks and the language in the statute regarding other moneyed capital in the hands of individual citizens was not given a literal interpretation.[14]

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[12] The share tax was the original methodology allowed for taxing national banks. This methodology evolved in the era before income taxes. The tax was essentially a tax on intangible property and was always in lieu of any taxation of the personal property of the national banks. The real estate of banks has been subject to separate assessment by the states and has not been limited by federal law except that the valuations must of course be such that national banks are not subjected to discrimination through the acts of local assessors. *See State Ex. Rel. Bank v. Gehner*, 319 MO 1048, 1055, 5 S.W.2d 40 (Mo. 1928).

[13] See Section 5219.1(b) of the Revised Statutes of the United States (later 12 U.S.C.A. § 548.1(b))(emphasis added).

[14] For a very well written analysis of this situation see H. L. Lutz, *The Problem of National Bank Taxation with Special Reference to California*, included in the House Hearings: State Taxation of National Banks, Hearings on H.R. 8727 before

This narrow reading of "moneyed capital in the hands of individual citizens" changed dramatically when the Supreme Court handed down its decision in *Merchants' National Bank v. Richmond*, 256 U.S. 635 (1921). To quickly recite the facts of the *Richmond* case, the City of Richmond Virginia had authorized the taxation of bank shares at the rate of $1.75 for each one hundred dollars of assessed valuation. For the same tax year, 1915, the City of Richmond imposed a tax of ninety-five cents per hundred dollars of assessed valuation on other intangibles. *Id.* at 637. State banks and trust companies were taxed at the higher rate of $1.75 which also applied to the national banks, but some $6.25 million in bonds notes and other evidences of indebtedness was held outside of these institutions and taxed at the lower rate. *Id.* at 637-38. When reviewing the Virginia state court's holding that the ordinance was valid because no discrimination existed between the taxation of state banks and national banks, the Court stated: "This, however, is too narrow a view of § 5219." *Id.* at 638. The Court goes on to say:

> [W]hile the words "moneyed capital in the hands of individual citizens" do not include shares of stock in corporations that do not enter into competition with the national banks, they do include something besides shares in banking corporations and others that

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the House Committee on Banking and Currency, 70th Congress, First Session (May 27-28, 1928) at pages 85-93.

> enter into direct competition with those banks. They include . . . moneys invested in private banking . . . [and] investments of individuals in securities that represent money at interest and evidences of indebtedness such as normally enter into the business of banking.

*Id.* at 639.

The *Richmond* decision caused the states to come to Congress in 1923 to seek amendment of § 5219 to control what they saw as the damage to their tax systems caused by the decision.[15] However, it did not take very long for the U.S.

[15] The portion of the 1923 amendment dealing with competition with other moneyed capital was incorporated into section 5219.1(b) and read: "In the case of a tax on said shares the tax imposed shall not be at a greater rate than is assessed upon other moneyed capital in the hands of individual citizens of such State coming into competition with the business of national banks: *Provided*, That bonds, notes or other evidences of indebtedness in the hands of individual citizens not employed or engaged in the banking or investment business and representing merely personal investments not made in competition with such business, shall not be moneyed capital within the meaning of this section." (italics in the original other emphasis added to indicate the new language). The problem with the 1923 amendment turned out to be the language "not made in competition with such business."

Supreme court to hold that the 1923 amendment regarding "competition from other moneyed capital" did nothing to change the law set forth in the 1921 *Merchants' National Bank v. Richmond* case.

In *First National Bank v. Anderson*, 269 U.S. 341 (1926) the Court held that the new language in § 5219[16] was ineffective in changing the holding in the *Richmond* case. The *Anderson* Court's take on the amendment is as follows: "[I]n legal contemplation and practical effect the restriction [in §5219.1(b)] was the same before the reenactment as after." *Id.* at 350.

The Supreme Court had another opportunity to comment on § 5219.1(b) the very next year in several cases including *First National Bank v. Hartford*, 273 U.S. 548 (1927).[17] Here the Court cites the *Anderson* decision with approval for the proposition that by its terms the 1923 amendment only excludes from the purview of § 5219.1(b)'s restrictions moneyed capital not in competition with the national banks. *Id.* at 557. The *Hartford* court then went on to examine the

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[16] See footnote # 15 *supra*

[17] For a discussion of all three cases from the U.S. Supreme Court's 1927 term dealing with § 5219 of the United States Revised Statutes see H. L. Lutz, *The Problem of National Bank Taxation with Special Reference to California*, included in the House Hearings: State Taxation of National Banks, Hearings on H.R. 8727 before the House Committee on Banking and Currency, 70th Congress, First Session (May 27-28, 1928) at pages 89-92.

rationale behind Congress' restriction and stated: "Competition in the sense intended arises not from the character of the business of those who compete but from the manner of the employment of the capital at their command." *Id* at 557. The *Hartford* Court further explained that the restriction "was intended to prevent the fostering of unequal competition with the business of national banks by the aid of discriminatory taxation in favor of capital invested by institutions or individuals engaged either in similar businesses or in particular operations or investments like those of national banks." *Id* at 558.

For the forty-three year period from 1926 to 1969 section 5219 remained unchanged allowing the states four mutually exclusive alternative methods for taxing national banks.[18] The fact that federal law remained unchanged during this window of time is significant because it was during this time period that two important events took place in Missouri. The first was drafting and approval of Missouri Constitution of 1945 and the second was the drafting of Chapter 148 RSMo which included the tax on banks as well as the tax on credit institutions. Both the framing of the Missouri Constitution of 1945 and the drafting of Chapter 148 were greatly influenced the restrictions the federal government placed upon Missouri's taxation of national banks.

## IV. Taxation of Banks in Missouri.

[18] § 5219 RS (12 U.S.C.A. § 548); see also *General Electric Credit Corp. v. State Tax Comm'n*, 231 Or. 570, 580, 373 P.2d 974 (1962).

Until 1946, Missouri taxed banks upon the value of their shares.[19] This was the original method allowed by section 5219 before its amendments in 1923 and 1926 to allow for differing methods of taxation discussed previously.[20] In *State Ex. Rel Bank v. Gehner*, 319 Mo. 1048, 1055; 5 S.W2d 40 (Mo. 1928) the court described the taxation of banks in Missouri. The *Gehner* court states that real estate is taxed at the corporate level for both state and national banks, but personalty owned by the banks is not taxed to the banks, but is instead taxed indirectly by the levy of a share tax.[21] However, because Missouri had chosen the

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[19] *See First National Bank of St. Joseph v. Buchannan County*, 205 S.W.2d 726 (Mo. 1947)(describes the transition from the old share tax to the new excise tax under the Bank Tax Act of 1946).

[20] See *First National Bank of St. Joseph v. Buchanan County*, 205 S.W.2d 726 (Mo. 1947) for a discussion of the implementation of the new bank tax law as it applied to both national banks and state chartered banks. *See also Mercantile Bank National Ass'n v. Berra*, 796 S.W.2d 22, 25-26 (Mo. banc 1990) for a discussion of the adoption of Art. X § 4(c) of the Missouri constitution which authorized the legislature to substitute for the property tax on banks some other form of taxation.

[21] "Pursuant to the authority granted by said act of Congress [Revised Statutes § 5219], the Legislature of this State enacted Section 12775, Revised Statutes 1919, providing for the assessment and taxing alike of all shares of the capital

share tax it was required to treat competing moneyed capital equally and tax it at the same rate as the banks in order to comply with § 5219.1(b) as interpreted by the Supreme Court in *Merchants' National Bank v. Richmond* and *First National Bank v. Anderson*.

### A. The End of Missouri's Share Tax.

The Missouri Constitution of 1945 included new methods for the taxation of intangibles in Article X § 4(b). This provision changed the tax base for intangibles from a valuation based tax (as real property and other personalty is presently taxed) to a tax based on the yield of the intangible property (as income is presently taxed). In addition, Art. X § 4(b) capped the tax rate at eight percent of the yield of the intangible asset. It was anticipated by the framers of the 1945 Constitution that the application of Art. X § 4(b) to banks and other competing financial institutions would result in a substantial reduction in the amount of taxes paid by these companies to the state of Missouri and its political subdivisions. In reference to what would ultimately become Art. X § 4(b) Mr. Ethan Shepley, Chairman of the Tax Committee said:

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stock of both domestic and national banks in the manner authorized and allowed by said section 5219, Revised Statutes of the United States." *Gehner* at p. 1055. This is the traditional share tax later to be known as "method one" pursuant to 12 U.S.C.A. § 548.

> Now if this Convention should adopt the Committee's recommendation to classify intangibles[22] and apply a low rate, whether it be based on income, that is yield, or whether it would be based on ad valorem or value, it makes no difference; here would be the result. When you apply it to the bank shares, it will greatly reduce what the banks are now paying.

*Verbatim Stenotype Transcription of Debates,* 1943-1944 Mo. Const. Convention p. 5007(testimony of Ethan Shepley chairman of the Taxation Committee).

A brief example demonstrates the magnitude of this problem. The records of the Constitutional debates indicate that the rate of taxation for a bank under the old share tax in the City of St. Louis was $2.75 per $100 of assessed valuation.[23] The records from the debates also suggest that the valuations of bank shares were manipulated by "agreement" such that the banks were paying tax on reduced valuations of approximately sixty-five percent (65%) of the actual market value of

[22] See what ultimately became Art. X § 4(a) Mo. Const. for the classifications of property for purposes of Missouri taxation.

[23] *Verbatim Stenotype Transcription of Debates,* 1943-1944 Mo. Const. Convention p. 5007(testimony of Ethan Shepley chairman of the Taxation Committee).

their shares.[24] This leads to the conclusion that prior to the Constitutional changes a typical bank in St. Louis could be expected to pay share taxes of approximately $17.88 for each thousand dollars of true assessed valuation.[25]

These same debates of the constitutional convention of 1943-44 indicate that the intent of both the banks and the taxing authorities was to leave the banks paying the same amount of tax as was paid under the preexisting share tax.[26] This

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[24] *Verbatim Stenotype Transcription of Debates*, 1943-1944 Mo. Const. Convention p. 5007(testimony of Ethan Shepley chairman of the Taxation Committee).

[25] Assuming each share has a valuation of one thousand dollars, this amount is then reduced to $650 per the "agreement." The tax rate of $2.75 is then applied to this agreed upon assessed valuation yielding a tax liability of $17.88 ($650 x 2.75% = 17.88).

[26] The debates provide in pertinent part: "if this constitutional convention should adopt this Committee's recommendation to classify intangibles and apply a low rate [(what became Art. X § 4(b) and the legislature continues with the present share tax methodology applicable to the banks (as of 1939, the share tax was codified at § 10959, RSMo) this circumstance] will greatly reduce what the banks are now paying to support the local government . . . That was not wanted, either by the [Taxation] Committee or frankly by the banks . . . The banks, as I said before are not entitled taxes, present taxes reduced. We concede that they are high, but

would not be possible if the state were to continue taxing banks on their shares. A simple example illustrates that if a bank in St. Louis had a share of stock worth $1,000 and the maximum tax rate on the yield is capped at eight percent (per Art. X § 4(b)), then rate of return on this share would have to be twenty-two and thirty-five hundredths percent (22.35%) annually in order to produce an intangible tax liability of $17.88—the amount produced by this same share under the old share tax methodology.[27]

Hence, as anticipated, in 1945 the Missouri legislature amended the Missouri bank tax and adopted a tax measured by each bank's income from the previous year at a rate of seven percent pursuant to 12 U.S.C.A. §548.[28] In the process of completely restructuring Missouri's taxation of financial institutions into what is now Chapter 148 RSMo, the General Assembly would have been

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they're not too high and I don't think they contend that they are too high." *Verbatim Stenotype Transcription of Debates,* 1943-1944 Mo. Const. Convention p. 5007(testimony of Ethan Shepley chairman of the Taxation Committee).

[27] At the maximum tax rate of eight percent the $1,000 bond would need to yield $223.50 in interest annually in order to result in sufficient tax to replace the former share tax ($17.88/.08 = $223.50).

[28] In the revised statutes of 1949, § 148.030.1 actually states that the tax is to be measured by net income "in accordance with method numbered (4) as provided in 12 U.S.C.A. § 548."

aware of the constitutional delegates' expectations that the General Assembly would need to revamp the taxation of banks or else the state would suffer a substantial loss of revenue.[29]

In reforming the taxation of banks and financial institutions in Missouri the General Assembly would also have been aware of the limitations imposed on state taxation of national banks by 12 U.S.C. §548 itself and the interpretations of this section by the courts. Specifically, federal law prohibited states that chose to tax banks on their income or via a franchise tax measured by net income (Missouri's choice) from using a tax rate higher than the rate assessed against other financial corporations or higher than the highest of the rates assessed by the taxing State upon mercantile, manufacturing, and business corporations doing

[29] Mr. Shepley is on record at the constitutional debates as saying that in light of the substantial reduction in bank taxes that would result if the new intangibles tax were applied to the banks, "Under the circumstances, we have every right to expect that the General Assembly, instead of continuing to impose [the ad volorem tax on bank shares] will shift over to one of the other . . . three methods of taxation on banks and they will impose probably an excise tax measured by the earnings of the bank and will fix the rate so that it will at least preserve the revenue that now comes from the tax on bank shares. *Verbatim Stenotype Transcription of Debates*, 1943-1944 Mo. Const. Convention P. 5007

business within its limits.[30]" In fact, the debates from the Missouri Constitutional convention of 1943-1944 include the following language indicating that Missouri lawmakers were keenly aware of the restrictions federal law placed on their taxation of financial institutions:

> Now there are certain conditions in this federal act [§5219 or 12 U.S.C.A. § 548]. Generally speaking, they amount to this, that in exercising any of these rights to tax national banks, you must not apply to them a higher rate than is applied to state banks or other financial institutions.

*Verbatim Stenotype Transcription of Debates,* 1943-1944 Mo. Const. Convention P. 5007(testimony of Ethan Shepley)(emphasis added). The above-quoted language shows that Missouri lawmakers knew that federal law not only restricted their ability to tax national banks, but also impacted all other financial institutions

[30] §5219.1(c) carried over to 12 U.S.C.A § 548. The full text of § 5219.1(c) as far as it relates to tax rates is as follows: "In case of a tax on or according to or measured by net income of an association, the taxing State may, except in the case of a tax on net income, include the entire net income received from all sources, but the rate shall not be higher than the rate assessed upon other financial corporations nor higher than the highest of the rates assessed by the taxing State upon mercantile, manufacturing and business corporations doing business within its limits . . ." (emphasis added).

in Missouri. They knew that if Missouri were to choose method four (as it ultimately did), then Missouri would be saddled with the restrictions imposed by § 5219.1(c) (12 U.S.C.A. § 548.1(c)).

Missouri lawmakers would most likely have also been aware of the happenings in California on this subject since all of the states were in the same situation regarding the federal law, and California tends to be a leader in the field of state taxation. While § 5219.1(c) (12 U.S.C.A. § 548.1(c)) had not been interpreted by the United States Supreme Court by 1945 when the Missouri Legislature was formulating its new tax policy for financial institutions, the California Supreme Court had weighed in with its interpretation of § 5219.1(c)'s requirement that national banks could not be taxed at a higher rate than other financial corporations. The crux of the legal problem was that there had never been any case law interpreting what Congress meant by "other financial corporations."

**B. California's Interpretation of § 5219.1(c).**

In *Crown Finance Corporation v. McColgan*, 23 Cal.2d 280, 144 P.2d 331 (Ca. 1943), the California Supreme Court weighed in on the meaning of the term "other financial corporation." At the time this case came before the California Supreme Court, the State had already converted its taxation of banks from the method one share tax to the excise tax measured by net income

authorized as method four by § 5219.[31] At the time of this decision, California taxed financial corporations the same as banks, but taxed other corporations on a different basis. *Crown Finance* at 284. In commenting on the reason for classifying all "financial corporations" together, the California Supreme Court suggested that they were so classified to avoid discrimination against national banks. *Id.* Ultimately, then the California Supreme Court concluded in *Crown Finance* that the term "other financial corporation" found in § 5219.1(c) must mean a corporation that comes into competition with national banks and one that deals in money as distinguished from other commodities. *Id.* at 284-85.

The California Supreme Court thus equates the restrictions imposed by §5219.1(c) upon the states that elect either method three or four as essentially equivalent to § 5219.1(b)'s restrictions upon states opting to use the traditional share tax. Section 5219.1(b) requires that the tax on national banks cannot be greater than the tax on other moneyed capital in the hands of individuals that comes into competition with national banks. This interpretation by the *Crown*

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[31] *See H.A.S Loan Service , Inc. v. McColgan*, 21 Cal.2d 518, 133 P.2d 391 (1943)(The California Bank and Corporation Franchise Tax Act adopted method number four (4) as set forth in 12 U.S.C. A. § 548). This was the option to tax national banks using an excise tax measured by net income, the same methodology the Missouri General Assembly would choose two years after the issuance of these two California opinions.

*Finance* court therefore breathed fresh life into the Supreme Court's earlier decisions in *Merchants' National Bank v. Richmond*, 256 U.S. 635 (1921) and *First National Bank v. Anderson*, 269 U.S. 341 (1926). These were the very decisions which caused many of the states to petition Congress (unsuccessfully) to amend § 5219 in 1928. The States sought out Congress' help because they were faced with the difficult choice of either revamping their tax systems or their constitutions in order to accommodate § 5219.[32]

The companies which the *Crown Finance* court found to be in competition with national banks were in the business of purchasing conditional sales contracts and accounts receivable primarily from furniture dealers and clothiers. *Crown Finance* at 281. The court found that:

> The only reasonable conclusion from that evidence is that plaintiffs were in substantial competition with national banks. Both national banks and plaintiffs are engaging in the same general investment

[32] See State Taxation of National Banks, Hearings on H.R. 8727 before the House Committee on Banking and Currency, 70th Congress, First Session (May 27-28, 1928); with respect to California specifically see also *Union Oil Associates v. Johnson*, 2 Cal2d 727, 731-33, 43 P.2d 291 (Ca. 1935)(California was placed in a situation where bank tax revenues in excess of $22,000,000 were at risk unless a constitutional amendment could be passed to undo the damage caused by *Merchants' National Bank*, and *First National Bank of Hartford* among others).

> business, that is, a business where the dealing is in moneyed capital as distinguished from other commodities, and purchasing at a discount conditional sales contracts from retail dealers in household furnishings and equipment. While in all phases of the business of each there is not a parallel, that is, plaintiffs do not loan money whereas national banks do, competition may exist although it does not extend to all other aspects of the business of the national banks.

*Id.* at 286.

**C. The Missouri Legislative Session of 1945.**

Thus, going into the legislative session for 1945 the Missouri General Assembly would likely have been aware of the fact that California had held that the restrictions in § 5219(c), as applied to method number four, meant that other businesses that deal in money had to be taxed in a manner no less favorably than the national banks. And after the *Crown Finance* case, the Missouri General Assembly would have felt compelled to charge credit institutions at least as much in state taxes as it planned to impose upon the national banks. This helps to explain why the Missouri General Assembly grouped all financial institutions together in Chapter 148 and may also explain why it drafted the taxing statutes for all financial institutions using nearly identical language.

Although these actions of the General Assembly took place sixty years ago, the factors which motivated them sixty years ago are still important today in interpreting the tax on credit institutions because the relevant portions of the

Credit Institutions Tax Law of 1946 remain unchanged.[33] While Congress did act in 1969 to ease the restrictions federal law placed upon the taxation of national banks, these changes at the federal level did not cause Missouri to significantly change its scheme for taxing financial institutions.[34] Hence, to properly interpret the provisions of the Missouri Credit Institutions Tax Law of 1946, this Court must examine its provisions in their historical context taking into account the federal government's restrictions on how Missouri could tax financial institutions.

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[33] 3 Mo. Taxation Law and Practice, Taxation of Banks, § 17.3 provides: "[Even though] the restrictions of 12 U.S.C. § 548 have been substantially eliminated [by Pub. L. 91-156 (1969)] the Missouri Bank Tax must be construed with an eye toward the scope of permissible state taxation allowed under 12 U.S.C. §548 in 1946." Even though the courts have never interpreted the Credit Institutions Act of 1946, it is well accepted that when interpreting the Bank Tax Act of 1946 that the historical context must be taken into consideration and that that historical context relates to the mid 1940s. *See e.g. Mercantile Bank National Ass'n v. Berra*, 796 S.W.2d 22 (Mo. banc 1990); *Citizens Bank & Trust Co. v. Director of Revenue*, 639 S.W.2d 833 (Mo. 1982); *William A. Straub, Inc. v. City of St. Louis*, 506 S.W.2d 377 (Mo. 1974).

[34] Pub. L. 91-156 (1969). Note, while changes were made to the Bank Tax Act in 1986, they are not relevant to the issues before the court in this case as they mostly involved folding the franchise tax into Chapter 148 for banks.

## V. Missouri's Public Policy of Maintaining Tax Parity.

To better understand what the General Assembly intended when it enacted § 148.140.3, it helps to first examine Missouri's Bank Tax Act § 148.030.3. The credit mechanism in the Bank tax law was designed to promote this state's longstanding public policy of creating tax parity between state banks and national banks.[35] Thus, while federal law required that state banks could not be taxed more lightly than national banks, it had been the longstanding policy of the state of Missouri to not tax state banks any more heavily than national banks

[35] The Missouri Supreme Court in *In Re Holland Banking Co.*, 281 S.W. 702, 709 (Mo. banc 1926) was faced with the issue of whether deposits of state monies should be given priority over other creditors in a state chartered bank. The court noted that if the state's deposits were given priority over other creditors' deposits in state banks then the public might feel less secure in placing its money with state banks (because the public's deposits would receive lower priority in state banks than the same deposits would have received if placed in a national bank where the State of Missouri's deposits would not receive priority). In holding that the state was not entitled to priority over other creditors the Court states: "It is contrary to the policy of this state to permit discrimination against state banks in favor of national banks."

either.[36] To tax state banks more heavily than national banks would cause them to be less profitable investments than national banks and would cause capital to flow away from the state banks and into other financial organizations.[37] Hence, while

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[36] *See State Ex. Rel. Bank v. Gehner*, 319 Mo. 1048, 1055, 5 S.W.2d 40 (1928)(pursuant to § 5219, the Missouri legislature enacted section 12775 of the Revised Statutes 1919 providing for the assessment of and taxing alike of all the shares of the capital stock of both domestic and national banks in the manner authorized by . . . Section 5219). *See also Mercantile Bank Nat. Assn. v. Berra*, 796 S.W.2d 22, 23 (Mo. banc 1990) where the issue before the court was whether the bank tax could legally be substituted for the personal property tax of banks. In tracing the history of bank taxation in Missouri the *Berra* court states: "Because Missouri consistently maintained a policy of taxing state banks in the same manner as those operating under national charters, thus maintaining tax parity between the two, the share tax also operated on state banks which were otherwise spared taxation." (citations omitted)

[37] When Congress amended the bank tax law in 1969, the legislative history notes that states have struggled mightily in their attempts to comply with the federal law and at the same time create tax parity. "Regardless of the method employed by the particular state in an attempt to achieve [tax] equality, there is always a question of whether it has actually been achieved, be it equality between State and National banks, or equality between banks and other businesses. Pub. L. 91-156 2 USCAN

the legislators meeting in Jefferson City in 1945 strove to meet the requirements of § 5219.1(c) regarding financial institutions competing with the national banks, they also sought to insure that these state financial institutions would not be placed at a tax disadvantage in the marketplace for capital.

### A. The Credit Mechanisms in §§ 148.030.3 and 148.140.3.

The Portion of the Credit Institutions Tax Act of 1946 before the Court for interpretation is § 148.140.3. It provides: "Each taxpayer shall be entitled to credits against the tax imposed by [this Act] for all taxes paid to the State of Missouri or any political subdivision thereof during the relevant income period, other than taxes on real estate, contributions paid pursuant to the unemployment compensation tax law of Missouri and taxes imposed on said sections." This section tracks nearly word for word with § 148.030.3, RSMo 1949 from Missouri's Bank Tax Act.[38]

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91st Congress First Session p.p. 1594-95 (1969). This excerpt shows that Congress was aware that its restrictions on taxing national banks were causing all of the states to struggle within the limits of their constitutions and tax laws not only to meet the requirements of federal law, but also to create tax parity between banks and other financial institutions and even more broadly other businesses in general.

[38] Each taxpayer shall be entitled to credits against the tax imposed by this law for all taxes paid to the state of Missouri or any political subdivision thereof during

The reason the credit mechanism[39] was necessary in the first instance was the restrictions which the federal government placed upon the states' ability to tax national banks. While § 5219 offered the states a choice of four different methods of taxation, each of these methods once chosen became the only means of taxing national banks.[40] Thus, when a state like Missouri chose to apply method four it permitted Missouri to impose a franchise tax measured by the net income of the national banks and a tax on the dividends received by national bank shareholders, as well as a tax upon the national banks' real property. But this election also precluded Missouri and its political subdivisions form laying any other taxes upon

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the relevant income period, other than taxes on real estate, contributions paid pursuant to the unemployment compensation tax law of Missouri and taxes imposed by this law. § 148.030.3, RSMo. 1949.

[39] The term "credit mechanism" is used here to refer generically to the language in § 148.030.3 providing banks a credit against their Missouri bank tax liability for most other taxes they paid to the state and its political subdivisions.

[40] See *Agricultural Bank v. Tax Comm'n*, 392 U.S. 339, 343 (1968) where the Court states: "It seems clear to us from the legislative history that 12 U.S.C. § 548 was intended to prescribe the only ways in which the States can tax national banks."

the national banks.[41] For example, national banks would have been excluded from Missouri personal property taxes, the Missouri income tax and the Missouri sales tax in 1946. *Agricultural Bank v. Tax Comm'n*, 392 U.S. 339, 342 (1968)(12 U.S.C.A. § 548 only allows states to tax national banks in any one of four specified ways in addition to a tax on their real property).[42]

In order to level the playing field for state banks which were not exempted from the imposition of the Missouri personal property taxes, the state income tax and the state sales tax among others, the General Assembly created § 148.030.3 to allow state chartered banks a credit against their Missouri bank tax liabilities for these other taxes. Under most circumstances, the economic result of

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[41] The 1969 amendment to 12 U.S.C.A. § 548 removed the strictly alternative methodologies previously imposed upon the states. Once fully implemented, these changes allowed states to impose any taxes it wished upon the national banks so long as state banks were taxed equivalently.

[42] In the *Agricultural Bank* case the Court held that a national bank was not subject to the Massachusetts sales and use tax because 12 U.S.C.A. § 548 did not allow the imposition of sales taxes among the four alternative taxing schemes that were permitted. *Id.* at 346. The logic of the *Agricultural Bank* case that 12 U.S.C.A. § 548 prescribed the only permissible methods for taxing a national bank can easily be extended to the other state taxes Missouri imposed on other businesses such as the income tax and the personal property tax.

this credit mechanism would be that a state bank would pay the same amount of total taxes to the state of Missouri as would a similarly situated national bank. This was the General Assembly's chosen methodology for continuing the state's policy of tax parity between state banks and national banks.

## VI. The Credit Institutions Tax Act of 1946.

Like state chartered banks, Missouri credit institutions were likely to be considered in competition with national banks for moneyed capital when the State Legislature met in 1945 to rewrite the Missouri tax laws applicable to financial institutions.[43] Thus, Missouri credit institutions had to be included in the General

[43]This conclusion can be drawn not only from the California Supreme Court's decision in *Crown Finance* discussed earlier, but also the United States Supreme Court's decision in *First National Bank v.* Anderson, 269 U.S. 341, 349-51 (1926)(affirming the Court's decision in *Merchants' National* Bank that § 5219 scope protected national bank from all moneyed capital in competition with national banks and not just from competition from state chartered banks). Although decided well after Chapter 148 was originally crafted, at least one Supreme Court Judge has lent some credence to this concept. In a concurring opinion in *Jefferson Savings & Loan Ass'n v. Goldberg*, 626 S.W.2d 640, 645 (Mo. banc 1982), Judge Welliver writes: "The only institution covered in Chapter 148, RSMo 1978, entitled 'Taxation of Financial Institutions,' which is clearly

Assembly's overall plan for taxing financial institutions so as to insure that national banks were not discriminated against. That the General Assembly considered this problem is evident from the manner in which the credit institutions tax is imposed in § 148.140.1 and from the base for computing the tax as set forth in § 148.150 and also in the rate of the tax set as 7% of net income as set forth in § 148.140.2. There are only minor differences, if any, between these sections and their counterparts in the Bank Tax Act of 1946 found in §§ 148.030.1, 148.040 and 148.030.2 respectively.

As credit institutions were required to be taxed no less than national banks, there is a strong indication based upon the language of the credit mechanism in § 148.140.3 that the General Assembly also wished to confer tax parity upon the credit institutions vis-à-vis the national banks and state banks. If it is true that the General Assembly intended for credit institutions to receive tax parity with national banks and state banks, for to do otherwise would encourage this capital to flow out of state or into other financial institutions, does it make sense that the only credit institutions not to receive tax parity would be partnerships and S corporations?[44] Appellant asserts that the legislature carefully

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distinguishable from the other institutions is insurance companies, perhaps for the reason that insurance companies are not in fact 'financial institutions.'"

[44] S corporations would not have been contemplated by the General Assembly in 1945 because they were not written into the tax code until 1958. Later Missouri

considered the tax consequences not just based on the taxes imposed in Chapter 148 itself, but all Missouri taxes imposed not only at the state level, but also at the local level in crafting the tax provisions of Chapter 148 with the goal of creating tax parity between the banks and credit institutions when it created the Missouri Credit Institutions Tax Act of 1946. The legislature would have been forced to make these sorts of complex calculations because of 12 U.S.C.A. § 548. However, in creating § 148.140.3's credit mechanism, the 1945 legislature intended not only to meet the mandates of 12 U.S.C.A. § 548, but also to continue Missouri's policy of maintaining tax parity among competing financial institutions.

If the AHC's interpretation of § 148.140.3 is correct, then the legislature failed in its mission to create tax parity, at least with respect to credit institutions organized as partnerships. Appellant asserts that the legislature's well thought out

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case law makes clear that S corporations are taxed just like partnerships. *See Wolff v. Director of Revenue*, 791 S.W.2d 390, 391-92 (Mo. banc 1990)(Section 143.471 adopts the partnership statutes--§ 143.441, RSMo—as the model for taxing shareholders of S corporations). Hence, this brief focuses primarily on partnership taxation which would have been considered by the General Assembly in 1945.

plan for creating tax parity could not have simply overlooked the partnerships.[45] To do so would have sent a message to these businesses to move out of state or reorganize into other types of business organizations. Surely if the legislature had intended this type of tax disadvantage should befall partnerships it would have explicitly stated its intent to leave the partnerships to bear a higher burden of taxation than the other forms of business organizations operating as financial organizations.[46]

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[45] Section 148.130(2) defines a "credit institution" as "every person, firm, partnership or corporation . . ." and then goes on to describe the business of a credit institution. (emphasis added). This quoted language clearly shows that the General Assembly contemplated some Missouri credit institutions were organized as partnerships. This definitional section has not been amended since its original creation in 1945.

[46] Normally, in the tax world, a C corporation is taxed more heavily than an S corporation owing to the fact that the C corporation pays a corporate level income tax and its shareholders must also pay tax on that portion of the corporate earnings that are actually distributed to the shareholders. However, under the AHC's interpretation of § 148.140.3, an S corporation now must bear a higher Missouri tax burden than a C corporation. The reason for this anomaly is that the C corporation will receive a dollar for dollar credit against its Missouri financial institutions tax for the Missouri corporate income tax it pays. All other things

In interpreting the credit provision found in § 148.140.3, the AHC did not look at the legislative purpose in creating Chapter 148 or how the taxes imposed in Chapter 148 were intended to interact with the other state and local level taxes to create tax parity in an environment where national banks, state banks and credit institutions all compete in the same arena for the same capital. Yet without the delicate balancing provisions which the General Assembly saw fit to place into Chapter 148, the national banks would be given an unfair tax advantage by federal law. The purpose of the provision for granting a credit against the Chapter 148 taxes in § 148.030.3(for state banks) and § 148.140.3 (for the credit institutions) was to level the playing field for the state financial institutions vis-à-vis the national banks.[47] By taxing all these institutions to the same degree, parity was achieved.

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being equal, the overall tax burden borne by the S corporation financial institution and its shareholders is now higher according to the AHC because the S corporation's shareholders must pay the Missouri income tax on the every dollar of corporate earnings (regardless of whether it is actually distributed) and there is no credit available to the shareholders to offset financial institutions tax imposed on it.

[47] Even though Congress did change the playing field substantially in 1969 when it amended 12 U.S.C.A. § 548, this event should be disregarded in interpreting

## VII. Discrimination Against S Corporations.

Because of the fiction that all of the income of an S corporation is deemed distributed to its shareholders in the year it is earned and because the Department and now the AHC have taken the position that MAC is not entitled to a credit for either the Missouri income tax paid by its shareholders or based upon a pro-forma Missouri corporate income tax return, MAC finds itself discriminated against in that its total Missouri taxes are higher than competing financial institutions.[48] In the circumstances of the income tax on an S corporation not subjected to the financial institutions tax this court found that Missouri's taxation of the entire amount of the deemed dividend to a Missouri resident was just one of the consequences of electing "S" status. *Wolff v. Director of Revenue,* 791 S.W.2d 390 (Mo. banc 1990). However, this result seems unwarranted and contrary to the expectations of the General Assembly when the financial institutions tax is

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§ 148.140.3 because at the time it was created in 1945, Missouri was severely restricted in its taxation of national banks as discussed herein. More importantly, § 148.140 has not been amended since 1949 and thus the Missouri legislature has left this credit mechanism in its original form.

[48] See *Hirsch v. State Tax Comm'n*, 646 S.W.2d 59, 60 (Mo. banc 1983) where the Court makes clear that an S corporation under Missouri law is not subjected to the corporate income tax, but must include in his or her individual adjusted gross income his or her pro rata share of the entire S corporation's income.

involved because of the legislature's longstanding policy of attempting to create tax parity among the financial institutions. The AHC's interpretation of § 148.140.3 means that not only are credit institutions organized as S corporations and their shareholders taxed more heavily than similarly situated banks[49], but they

[49] Banks organized as S corporations do now receive a credit against their Missouri bank tax for income taxes. This is accomplished via § 148.031 which allows a bank organized as an S corporation to compute what is referred to as the substitute franchise tax and is computed as though the corporation were a C corporation. This allows the S corporation bank to claim a credit against its substitute Missouri franchise tax for the amount of Missouri income tax computed as though the corporation had not elected S status. Not only does the S corporation bank now receive a credit against its substitute Missouri bank tax for the pro-forma income tax computed as though it were a C corporation, but also the shareholders obtain an additional credit against their individual income taxes for their prorate shares of the corporation's substitute franchise tax pursuant to § 148.112. Both § 148.031 and § 148.112 were enacted in 1998 shortly after the federal law change which permitted banks to be organized as S corporations. *See also* Mo. Priv. Ltr. Rul. No. 1633 (September 5, 2003).

are also taxed more heavily than other credit institutions which are organized as either corporations or sole proprietorships.[50]

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[50] Respondent admits in its Response to Petitioner's Cross Motion for Summary Determination that the Department of Revenue would grant a tax credit for individual income taxes paid against the Missouri credit institutions tax of a sole proprietor. (L.F. 215). This credit is given even though the sole proprietorship does not file a Missouri income tax return. The owner of the sole proprietorship does file a tax return but the income of the sole proprietor form other sources is blended with the schedule C income in computing the taxable income of the individual owner. Likewise other deductions not related to the operation of the Missouri credit institution (such as the personal exemption and dependent deductions of the owner) would be taken into account in computing the owner's Missouri individual income tax liability. As such there is no direct correlation between the income of the credit institution and the owner's Missouri individual income tax liability. Instead, the Department must somehow attempt to determine what portion of the owner's Missouri individual income tax liability is really attributable to the operation of the Missouri credit institution in order to compute the amount of the credit which it should receive against its Missouri credit institutions tax. This determination is by its nature artificial since the Missouri credit institution is not liable for Missouri income tax when organized as a sole proprietorship. Since the Department does, nevertheless allow a credit, this leaves

In order to continue Missouri's longstanding policy of creating tax parity between financial organizations, this Court should hold that the AHC's decision does not meet with the expectations of the General Assembly. This Court should allow the Appellant to take a credit against its Missouri financial institutions tax for either the Missouri individual income taxes paid by its shareholders attributable to distributions from the Appellant, or alternatively allow a credit for a substitute credit institutions tax similar to the credit allowed in § 148.031. After all, the taxes paid by the shareholders are clearly based on the taxable income of the corporation that would, but for the S election have been reported instead on a Missouri corporate income tax return.

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S corporations and partnerships as the only entities which the Department asserts are not entitled to the credit.

## CONCLUSION

In view of the foregoing, this Court should reverse the decision of the Administrative Hearing Commission and allow MAC a credit against its Missouri credit institutions tax for either the income taxes paid by its shareholders attributable to on the income they received from MAC or, alternatively, the Missouri corporate income taxes MAC would have paid had it been organized as a "C" corporation rather than as an "S" corporation.

Respectfully submitted,

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**Certification of Service and of Compliance with Rule 84.06(b) and 84.06(c)**

The undersigned hereby certifies that on September ____, 2005 on true and correct copy of the foregoing brief, and one disk containing the foregoing brief were mailed postage prepaid to:

Mr. James R. Layton
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The Undersigned further certifies that the foregoing brief complies with the limitations contained in Rule Number 84.06(b), and that this brief contains 11,386 words. The undersigned further certifies that the labeled disk filed contemporaneously with the hard copies of this brief has been scanned for viruses and is virus-free.

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Daniel J. Cook